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Politics this week

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A grand illusion

Plans for a “grand coalition” in **Germany** were thrown into disarray when two of its main backers stepped down. Franz Müntefering quit as chairman of the Social Democrats after failing to get his candidate chosen as party secretary. Edmund Stoiber, head of the Bavarian Christian Social Union, then said he would not serve as economics minister. The would-be chancellor and head of the Christian Democrats, Angela Merkel, insisted that she would create a grand coalition anyway. See article

Paris was convulsed by several days of rioting in the suburbs after two North Africans died, allegedly while fleeing police. France's prime minister, Dominique de Villepin, cancelled a trip to Canada to deal with the consequences.

EPA

The conservative Law and Justice Party, which took the most seats in **Poland's** election in September, formed a minority government with Kazimierz Marcinkiewicz as prime minister. The government drew support from a populist party led by Andrzej Lepper, but not from the second-biggest conservative party, Civic Platform. See article

Britain's work and pensions secretary, **David Blunkett**, resigned from Tony Blair's cabinet (again). He had failed to follow the proper rules over shareholdings and directorships after he quit as home secretary last December over an affair. See article

Trading up

On the eve of a 34-country **Summit of the Americas** in Argentina, George Bush admitted that a plan for a Pan-American free-trade area had “stalled”. He said the Doha round of world trade talks was more important. See article

An inquiry into the abuse of a scheme by **Canada's** Liberal government to promote federalism in Quebec exonerated Paul Martin, the prime minister, but blamed Jean Chrétien, his predecessor, for “omissions” and several of his officials for mismanagement. See article

A report in *Veja*, **Brazil's** leading news magazine, claimed that the Workers' Party of President Luiz Inácio Lula da Silva received $3m from the Cuban government for its election campaign in 2002. Brazil's electoral law bans foreign donations. The party's president and the Cuban government both denied the claim.

Bolivia's caretaker president, Eduardo Rodríguez, issued a decree postponing his country's

general election by two weeks to December 18th, after Congress had failed to settle a row over redistricting. The president's decree awards four extra seats to the more prosperous east at the expense of the highland west.

Foolish words—and actions

AFP

Iran's new president, Mahmoud Ahmadinejad, refused to recant after western leaders reacted with outrage to his remarks last week that Israel's "occupying regime" should be "wiped off the map". Moreover, Iran seemed set to start processing a new batch of uranium at its Isfahan nuclear plant—despite western pressure to halt all such activities. See article

The UN Security Council unanimously told **Syria** to co-operate more fully with a UN investigation into the killing of a former Lebanese prime minister, Rafik Hariri, or face "further action", meaning economic sanctions. Syrians suspected of involvement in the killings, some very close to President Bashar Assad, could face a ban on travel and have their foreign assets frozen.

In **Zimbabwe**, a minister in President Robert Mugabe's government admitted that the forcible seizure of mostly white-owned farms had contributed to the current massive crop failure in the country. Farms had been given to "people without the faintest idea of farming".

In the **Ethiopian** capital, Addis Ababa, at least 27 were left dead and hundreds injured during continuing protests against the outcome of elections in May won by the government. Opposition groups claim that the election was rigged, and some of their leaders have been arrested.

In **Zanzibar** violence broke out after the ruling Party of the Revolution was declared the winner of presidential and parliamentary elections. The main opposition party, losing for the third time in a row, said the poll had been rigged and promised mass protests. See article

Market massacres

A series of three co-ordinated bombs exploded in **Delhi**, killing at least 60 people ahead of Hindu and Muslim religious festivals. Militants based in Pakistan were suspected, and fears were raised that relations between India and Pakistan would suffer. See article

North Korea and **South Korea** said they would compete as a single nation in the 2008 Beijing Olympic games.

Australia's prime minister, John Howard, gave warning of a specific terrorist threat to the country. He was also seeking enhanced anti-terrorism powers. Australia has never been attacked on its own soil, though Australians have repeatedly been targeted in neighbouring Indonesia.

Japan's prime minister, Junichiro Koizumi, reshuffled his cabinet. One effect was to promote a relatively young and telegenic politician, Shinzo Abe, seen as a potential successor to Mr Koizumi. See article

Normal service is resumed

George Bush nominated Samuel Alito, a conservative federal appeals-court judge to the **Supreme Court**, replacing Harriet Miers, who withdrew her nomination last week. See article

Thousands of mourners attended the funeral in Detroit of **Rosa Parks**, the black civil-rights heroine who died last week at the age of 92. Prior to the service, Mrs Parks became the first woman to lie in public under the Capitol dome in Washington, DC. See article

Reuters

The *Washington Post* revealed that the CIA operates a system of **secret prisons** for al-Qaeda suspects in eight countries in Asia and eastern Europe. The administration refused to confirm the prisons' existence but insisted that torture was not allowed at them.

Voters in **Colorado** overturned the “taxpayers' bill of rights”, which had pegged state spending to consumer prices and provided tax refunds worth billions of dollars. The measure, which passed by 52% to 48%, was supported by Governor Bill Owens who claimed it severely curtailed legislators' ability to raise revenue.

Mr Bush presented a $7.1 billion vaccine development and stockpiling plan to tackle any potential **bird flu** pandemic in the United States.

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Business this week

Nov 3rd 2005
From The Economist print edition

European telecoms

Telefónica made an offer to buy **O2**, one of Britain's biggest mobile-network operators, valued at £17.7 billion ($31.5 billion). The Spanish telecoms firm has seen its domestic market weaken recently and has been hoping to expand (Telefónica also operates in Latin America). The recommended deal will create the world's second-largest telecoms company by customer numbers if successful. See article

Deutsche Telekom (which ruled out making a counterbid for O2) announced a staff restructuring plan that cuts 19,000 jobs (net) in Germany, mostly in its land-line unit. Europe's biggest telecoms company said the programme was “socially acceptable”, but it still needs union approval.

Barrick Gold, a mining company based in Canada, began a $9.2 billion bid to buy **Placer Dome**, a rival. If completed, the combination would make Barrick the world's largest gold-miner, producing 8.4m ounces of gold this year.

Blast from the past

Liquidators for the **Bank of Credit and Commerce International** dropped their 12-year £850m ($1.5 billion) lawsuit against the Bank of England. BCCI collapsed spectacularly in 1991 with over £9 billion in debts; in 1993 Deloitte, BCCI's liquidators, claimed the central bank had acted in “bad faith” by failing to protect investors. The trial, which began two years ago with an opening speech lasting 119 days, the longest in English legal history, is expected to cost the Bank of England over £70m by the end of this year, which it said it will seek to recover from Deloitte.

Regulators in Britain cleared the way for a potential bid for the **London Stock Exchange** by Euronext (conditioned on Euronext reducing its stake in clearings operations). However, the European financial-exchange operator, which has yet to make a formal offer, may face an investor backlash to any move on the LSE, similar to the rebellion that ousted Deutsche Börse's boss in May. See article

UBS led a clutch of European financial institutions in reporting record quarterly profits. The Swiss group said third-quarter net income had risen by 71% compared with a year earlier to SFr2.8 billion ($2.2 billion). Profit was bolstered by clients in Middle Eastern and Asian countries, who poured their funds into UBS's wealth-management plans.

Carl's on the Case

Responding to a hostile campaign by Carl Icahn's investor consortium to increase its share value,

Time Warner more than doubled the value of shares it has committed to buy back over 21 months to $12.5 billion (Mr Icahn wants a $20 billion buy-back). The media group also announced that Steve Case was stepping down from its board with immediate effect. Mr Case, a co-founder of AOL, is blamed by many (including Mr Icahn) for the disastrous merger between the two firms in 2000.

Novartis raised its offer to buy the 58% of **Chiron** it does not already own to $5.1 billion, which the vaccine-maker's board recommended to shareholders (a lower offer was rejected in September). Novartis is reorganising its vaccine business to meet the growing demand for flu shots.

United Airlines reported its biggest-ever quarterly net loss—$1.8 billion—and blamed reorganisation costs. The carrier is hoping to emerge from over three years of bankruptcy protection by the end of February.

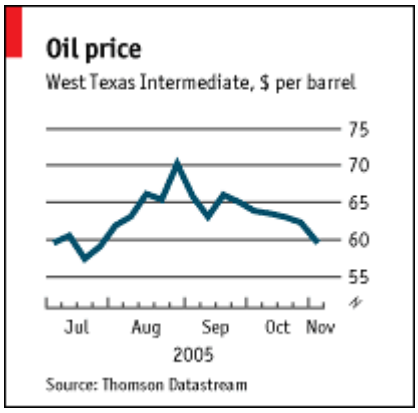
Ryanair's chief executive, Michael O'Leary, said he hoped to introduce gambling facilities on flights by 2007. The European low-cost airline thinks the move might generate so much revenue that it wouldn't have to charge passengers for air fares.

P&O's share price rose by over 30% on October 31st on speculation that the British ferries and ports operator could be subject to a $5 billion bidding war. (Shippers P&O Nedlloyd, a separate entity, was recently bought by A.P. Moller-Maersk.) Dubai Ports World, owned by the United Arab Emirates government, is the front-runner to buy the 165-year-old firm.

America's Federal Reserve increased its main **interest rate** by one-quarter of a percentage point to 4%. It is expected to raise rates further to curb inflation. Last week, the Commerce Department reported that America's **GDP** had grown at an annual rate of 3.8% in the third quarter due to strong personal consumption expenditures (and despite the devastating hurricanes).

Falling from the peak

Oil prices fell to below $60 a barrel for the first time since July as warmer weather in parts of America dampened demand for heating oil. Some analysts speculated that a post-hurricane psychology and pleas from the government for consumers to curb their use of petrol also fed into the fall.



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Trade and poverty

Tired of globalisation

Nov 3rd 2005
From The Economist print edition

But trade liberalisation and other forms of openness are needed more than ever

Get article background

FREDERIC BASTIAT, who was that rarest of creatures, a French free-market economist, wrote to this newspaper in 1846 to express a noble and romantic hope: “May all the nations soon throw down the barriers which separate them.” Those words were echoed 125 years later by the call of John Lennon, who was not an economist but a rather successful global capitalist, to “imagine there's no countries”. As he said in his 1971 song, it isn't hard to do. But despite the spectacular rise in living standards that has occurred as barriers between nations have fallen, and despite the resulting escape from poverty by hundreds of millions of people in those places that have joined the world economy, it is still hard to convince publics and politicians of the merits of openness. Now, once again, a queue is forming to denounce openness—ie, globalisation. It is putting at risk the next big advance in trade liberalisation and the next big reduction in poverty in the developing countries.

In Washington, DC, home of a fabled “consensus” about poor countries' economic policies, a bill before Congress devised by one of New York's senators, Charles Schumer, threatens a 27.5% tariff on imports from China if that country does not revalue its currency by an equivalent amount. In Mr Schumer's view, presumably, far too many Chinese peasants are escaping poverty. On November 4th George Bush will escape the febrile atmosphere along Pennsylvania Avenue by visiting Argentina to attend the 34-country Summit of the Americas. There he will be greeted by a rally against “imperialism”, by which is meant him personally, the Iraq war and the Free Trade Area of the Americas which he espouses. Among the hoped-for 50,000 demonstrators will be Diego Maradona, who as a footballer became rich through the game's global market and as a cocaine-addict was dependent on barrier-busting international trade; and naturally his fellow-

summiteer, Hugo Chávez, who is using trade in high-priced oil to finance his “21st-century socialism” in Venezuela.

All, perhaps, the normal fun of a Latin American visit. Last week's Latinobarómetro opinion poll revealed that whatever the protesters may say, a clear majority in all the region's countries favour a market economy rather than a closed, state-directed one—even in Venezuela (see article). This is, however, a difficult moment for the market economy and for relations between rich countries and poorer ones, for the Doha round of trade-liberalisation talks under the World Trade Organisation are in trouble. When it began in 2001, the round was billed as a big effort to boost growth in poor countries, and the lowering of barriers to food trade was placed at its centre. In the past few weeks, however, a fairly bold American proposal for reducing its farm protection has been greeted by a much weaker response from the European Union and none at all from Japan. And ministers from Bastiat's own country, France, have vied with one another to denounce all talk of further reform to the EU's common agricultural policy. Europe must, they say, remain an “agricultural power” even at the expense of the taxpayer and the poor, and, according to President Jacques Chirac, must fight back “liberalism”. Whatever happened to *Liberté, Egalité, Fraternité*?

The world will find out, to some extent, next month when ministers from the 148 countries in the WTO meet in Hong Kong. The last time they gathered for such a crucial meeting was in September 2003 in Cancún, and the result was a shambles. There was a bitter row between rich countries and poor ones, and the meeting broke up in acrimony. At that stage, however, there was still plenty of time to repair the damage. For in effect the deadline for the Doha round comes in June 2007, when the trade-negotiating authority granted by Congress to President Bush expires. But, although that leaves more than a year and a half after Hong Kong, the complexity of a negotiation involving 148 countries and scores of highly technical issues means that the deal really needs to be done during 2006, with the political framework for it set early on—which essentially means in Hong Kong.

The case for selfish generosity

Trade-liberalisation rounds are arcane affairs about which free-traders are often thought to cry wolf. The previous talks, known as the Uruguay round, went through lots of brinkmanship and delays before they were completed. The result was still disappointing in many ways, especially to developing countries, and yet since the round's completion in 1993 the world economy has grown lustily and the biggest developing countries, China, India and Brazil, have all burst on to the global trading scene. Would the world really be hurt if the EU merely refuses to expose its farmers to more competition?

The likeliest outcome both from the Hong Kong meeting and the eventual Doha agreement is a compromise—as always. The European position is feeble but not risible, for it has offered an overall average cut in its farm tariffs of 39%, up from 25% only a month ago, though with rather a lot of loopholes that could severely limit the benefits. France, and other European farm protectionists, may prove more flexible than they currently imply: this is hardly the first time they have promised to man the barricades shortly before striking a deal. Yet though some sort of fudge in Hong Kong must be likely, with the Americans lowering their ambition and the Europeans raising theirs a little, such an outcome would still represent both a missed opportunity and a risk.

The missed opportunity is that Doha has offered the first proper chance to involve developing countries in trade negotiations—they now make up two-thirds of the WTO members—but also thereby to use a full exchange of agricultural, industrial and service liberalisations to make a big advance in free trade that could benefit a wide range of countries. Some of that progress may still be made, even in a fudged deal: Brazil, for example, stands to benefit hugely from freer trade in agriculture (see article), so it should be willing to promote other concessions in return. India is

reluctant to cut its own farm tariffs but has a big interest in liberalising trade in services, wanting more freedom in everything from finance to health care to entertainment. But if the rich world could gird itself to be more ambitious on agriculture the gains would be even greater: help for the poorest countries, making the rich look generous; better access to the biggest and richest developing countries for western companies; and a rise in global income in a decade's time of $300 billion a year (says the World Bank), which would thus help everyone.

The risk is that failure to agree on a new wave of openness during a period (the past two years) in which the world economy has been growing at its fastest for three decades, with more countries sharing in that growth than ever before, will set a sour political note for what may well be tougher times ahead. A turn away from trade liberalisation just ahead of an American recession, say, or a Chinese economic slowdown, could open up a chance not just for a slowdown in progress but for a rollback. Currently, for example, the Schumer bill to put a penal tariff on Chinese goods looks unlikely to pass. If American unemployment were rising and world trade talks had turned acrimonious, that might change. So might the political wind in many developing countries.

If so, that would be a tragedy for the whole world. Although the case for reducing poverty by sending more aid to the poorest countries has some merit, the experience of China, South Korea, Chile and India shows that the much better and more powerful way to deal with poverty is to use the solution that worked in the past in America, western Europe and Japan: open, trading economies, exploiting the full infrastructure of capitalism (including financial services—see our survey on microfinance) amid a rule of law provided by government. In other words, globalisation. To paraphrase Samuel Johnson, anyone who is tired of that is tired of life.

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Windfall taxes

An oily slope

Nov 3rd 2005
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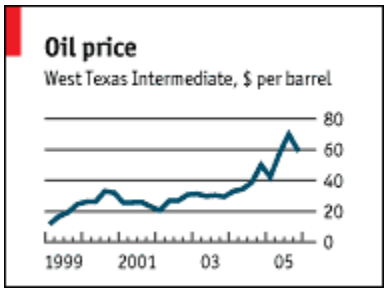
Governments should not seize companies' "excess" profits



"OIL companies have failed to tell us and show us what they are doing with these profits that justify them." With those angry words a Republican senator, Pete Domenici, demanded this week that the bosses of big oil companies testify in front of Congress—a challenge likely to be accepted by Lee Raymond, chairman of Exxon Mobil (which had just posted record third-quarter profits of nearly $10 billion). Other oil bosses are expected to fly into Washington, DC, next week for what is sure to be the most popular political roasting of corporate chiefs since tobacco bosses were summoned to Congress a few years ago.

Given popular anger over high energy prices, including for heating fuels as winter approaches, it is understandable that politicians want to be seen to be doing something. Unfortunately, the current populist frenzy has produced one really bad idea: the proposal, now being mooted seriously in Britain and America, for a windfall tax on oil companies' profits.

Surely it is no bad thing to grab excess profits on a one-off basis? After all, it raises unanticipated revenues. Windfall taxes might even bring a grim smile of satisfaction to voters' faces. But where should you stop? Why not take a swipe at over-paid hedge-fund managers, sports stars and sundry billionaires as well? Why not slap a tax on farmers if they benefit from a bumper harvest? How about a tax on Apple, which cannot sell its iPods fast enough?

Sadly for politicians, windfall taxes do cause harm. If they want to be trusted and effective, governments cannot go around arbitrarily grabbing legally earned money from successful companies or citizens—they grab plenty already in ways that people and firms can adapt to. And although windfall taxes do indeed bring in short-term revenues, they do significant harm because they distort long-term incentives. Worse, they purport to be able to distinguish between a healthy level of profits and an "excessive" one—something specialist antitrust authorities, not greedy governments, are best placed to judge. In the case of the oil industry, for example, one official investigation after another has failed to prove that consumers are the victims of price gouging at the petrol pump. Rather, prices are set in world trade and by the manipulative efforts of the OPEC cartel.

It is true, however, that oil companies have been happy to ride OPEC's coat-tails. That is why it is in their own interest to meet Senator Domenici's challenge. They need to give a good, public explanation of how they intend to use the overflowing coffers that have resulted from high prices. They should argue that the most pernicious effect of windfall taxes is to dampen future investment and thereby raise prices in the long run. The oil business is cyclical. It also has long lead times, so that today's profits would not be possible without investments made many years ago. A windfall tax would discourage capital investment in risky new oil and gas fields in non-OPEC countries just

at a time when western oil companies, still recovering from the cost-cutting caused by the collapse of oil prices (and profits) in 1998, urgently need to begin a new cycle of upstream investment. If non-OPEC production were to stagnate or decline, that would simply increase the market power of OPEC, making it more likely that prices will stay high.

Tax demands

If their interest is in energy policy rather than mere tax-gouging, politicians should address the demand side of oil, not the suppliers. This is particularly true in America, which guzzles far more energy per unit of economic output than its OECD rivals, and where vehicle fuel-efficiency is close to a 20-year low. A bipartisan group of legislators has just introduced a bill to tighten America's fuel-economy law for cars. Even better would be the embrace of an economy-wide carbon tax—a simple, elegant and economically efficient way to reduce energy use and to spur all manner of alternatives to oil (see article). Failing that, why not further raise taxes on consumption? Or make serious efforts to bolster energy-efficiency and conservation? Such humdrum measures may not produce a juicy televised grilling of fat-cat oil bosses. But unlike a windfall tax they might actually do some good.

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Azerbaijan's election

A Caspian contradiction

Nov 3rd 2005
From The Economist print edition

The two faces of Azerbaijan and its president

Get article background

IN THE inscrutable Caucasus, things are rarely what they seem. So it has been with the dual election campaign before the parliamentary vote in Azerbaijan on November 6th.

One campaign has involved decrees on electoral propriety from Ilham Aliev, Azerbaijan's president, the open registration of candidates, plans for exit-polling and the release of political prisoners. Beneath these niceties, however, lies another campaign that has alarmed foreign election and human-rights observers. This one features the beating and detention of opposition candidates and their supporters, media bias, and bizarre allegations of a coup plot that followed a mysteriously aborted homecoming by an exiled opposition leader. This election may yet be judged to have been little cleaner than the rigged presidential poll in 2003, when Mr Aliev succeeded his father Heidar, a Soviet-era boss who ran the country again for the last decade of his life.

Azerbaijan matters—much more than its neighbour, Georgia, which thanks to its telegenic, English-speaking president, Mikhail Saakashvili, has generally had a higher profile. Azerbaijan has more people (8m), and most are Muslims. It is in a rough neighbourhood: to the north is Dagestan, an anarchic region of Russia; to the south, Iran. It lost a chunk of its territory in a war with Armenia in the 1990s, and the two countries may yet fight another. Above all, it has oil and gas: new pipelines will soon carry both from the Caspian to the Mediterranean. And, like its election, Azerbaijan has two faces. It is a proud, booming nation with a westernised elite and a glamorous capital, Baku; it is also grotesquely corrupt, beset by clan rivalries, its bureaucrats fattening on backhanders while 40% of the country lives in poverty.

The oil, competition with Russia for influence in the former Soviet Union, plus Azerbaijan's strategic location, might suggest that America and the European Union should be content with Mr Aliev and the stability he seems to offer. But that would be the wrong policy: for the West, for its reputation in the wider Muslim world, and for Azerbaijan itself. The country's choice may be between allowing more democracy now and facing nastier change in a decade or so, after many of the petrodollars have been squandered. It is too late for this weekend's flawed election to be made perfect. But America and the EU could still try to ensure an orderly count, and—rather as they did in Ukraine last year—pressure the authorities to refrain from violence in the event of demonstrations.

The real test is for Mr Aliev, who is as much of a Caucasian enigma as his country. To westerners, the president talks of tackling corruption, spreading wealth and joining Europe. This Mr Aliev seems to understand that, since power in Azerbaijan mostly resides with the presidency (and his

parliamentary party is popular), he has more to lose than to gain from another rigged vote, and is striving to rein in unreconstructed election officials and over-zealous police. But the other Mr Aliev is secretly in cahoots with them. This other Mr Aliev denies the existence of flagrant human-rights abuses and cannot overcome a reflexive post-Soviet suspicion of opposition, or the belief that only overwhelming election victories count. Next week, it will not be enough for him to plead, as sham reformers tend to, that his is a country in transition: he must put an end to political harassment, and see that polling violations are punished. This is Mr Aliev's chance to prove that he can become a truly democratic leader, not just a simulacrum.

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Germany

A grand cock-up

Nov 3rd 2005
From The Economist print edition

More squabbles upset Angela Merkel's hopes of leading a strong government

AP

Get article background

IT WAS always going to be hard to form a “grand coalition” government out of the main centre-right and centre-left parties in Germany. Unfortunately, the inconclusive result of the election on September 18th left the politicians with little alternative. And until this week it seemed as if Angela Merkel, leader of the Christian Democrats (CDU), had succeeded in cobbling such a coalition together, enabling her later this month to become both the first woman and the first person to hail from the east ever to be Germany's federal chancellor.

Ms Merkel may yet fulfil her ambition. But after this week's shenanigans (see article), the timetable seems likely to slip—and the odds against her managing to form a grand coalition at all have risen sharply. The trouble began when the chairman of the Social Democratic Party (SPD), Franz Müntefering, quit his post after the party's executive chose a left-winger in place of his preferred moderate candidate as its general secretary. It is even possible that Mr Müntefering may not serve as Ms Merkel's putative vice-chancellor and labour minister either. But almost as shocking was the peremptory decision by Edmund Stoiber, leader of the CDU's sister party in Bavaria, the Christian Social Union, who is a friend of Mr Müntefering's, to pick up his marbles and go back to Munich rather than serve as Ms Merkel's economics minister in Berlin.

To look on the bright side, Ms Merkel might find a government without Mr Stoiber, who is no free-market liberal, easier to run, even if he carps from the sidelines. But the troubles within the SPD have confirmed that that party is tending to move leftwards. That makes the task of agreeing on any of the substantial further reforms that Germany needs (and that Ms Merkel says she wants) practically impossible. Any grand coalition that takes office now is likely to be even weaker and shorter-lived than had already seemed likely.

The politicians in Berlin are duty-bound to continue negotiating their way towards such a government, even so. Polls show that a large majority of German voters want to see a grand coalition. There seems to be no chance of any other coalition being assembled: the Green Party has ruled out joining one with the CDU and the Free Democrats (FDP), the FDP refuses to sign up with the SPD and the Greens, and nobody will work with the Left Party. Thus, if efforts to repair Ms Merkel's hoped-for grand coalition fail over the next few weeks, the only alternative will be a fresh election, probably next March, conceivably with new candidates for the chancellorship.

Indeed, that could yet be the best outcome, for it might give the CDU more votes and the SPD fewer. But a fresh election would also carry two big risks. One is that the result could be just as inconclusive as last September's, leaving the politicians in a similar mess. The other is that the smaller parties, particularly the Left Party, might be the big gainers, making the task of building any coalition harder than ever. In either case Germany could end up even more paralysed than it is now.

How much does any of this matter? With some tentative signs of economic recovery in Germany—as in the rest of Europe—it is a fair question. But the answer is that Germany still desperately needs a government that has both the strength and the desire to push through tough and potentially unpopular reforms if it is to get properly back to economic health. The fraught negotiations over a grand coalition, culminating in this week's drama, have already set back a budding revival in business and consumer confidence.

In search of leadership

The rest of Europe needs a strong and reforming German government too. It is hard for any countries in the euro area to thrive without faster growth in the biggest economy, Germany. Worse, it happens that all three core euro countries—Germany, France and Italy, which between them account for 70% of the euro area's GDP—are suffering from weak political leadership at the same time.

France seems to be in the grip of a sour anti-globalisation mood, and President Jacques Chirac is unlikely to run for the presidency for a third time in the spring of 2007. His lieutenants within the government are jockeying for the succession rather than taking any serious interest in reform. Italy is already in the midst of a campaign for the parliamentary election due in April 2006, and neither the centre-right government under Silvio Berlusconi nor the centre-left opposition under Romano Prodi appears to have much appetite for big structural change. No wonder so many economists are still gloomy about the future of Europe.

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Arnold Schwarzenegger's California

A girlie man, but a useful one

Nov 3rd 2005
From The Economist print edition

California's governor is proving a bit of a lightweight. All the more reason to give him support

AP

ANYBODY worried about America's absorption with celebrity politics can take some comfort from Arnold Schwarzenegger's plight. Two years ago, a blast of star power and some Teutonic one-liners helped elevate a muscle-bound hunk to the governorship of the world's eighth-largest economy. A year ago, despite him avoiding anything that looked like a hard question (unless you think bodybuilding magazines are probing interviewers), a movement was afoot among Republicans to change the constitution to allow the Austrian-born basher of Democratic “girlie men” to run for president.

Now the bloom seems to have come off Mr Schwarzenegger's *Edelweiss*. His campaign to persuade Californians to pass four initiatives next week to reform their state is in trouble (see article). Having promised to “kick the butts” of California's generally popular nurses, teachers and firemen, it is his own posterior that looks the more bruised after the unions have spent $60m attacking his plans. His approval rating, which stood at 60% when he launched his “year of reform” in January, is now at 33%. Californians increasingly seem to treat him as yet another politician, just as intent on raising money as his unlamented predecessor, Gray Davis. Democrats are increasingly confident that Mr Schwarzenegger, like Jesse Ventura, another celebrity who found politics more taxing than photocalls, may yet be a one-term governor.

Reassuring though it is to watch a political girlie man getting his come-uppance, there is another side to this story—namely the two very good ideas that Mr Schwarzenegger, however imperfectly, stands for. The first is western conservatism—the old Reaganesque creed of small government and

individual freedom which has always struck this newspaper as more attractive than the southern-fried moralism which rules the modern Republican Party. Mr Schwarzenegger, alongside that other populist hedonist Rudy Giuliani, is the most potent spokesman of this more liberated creed.

The second idea is reforming California's dysfunctional government. Although the Golden State's private sector is the envy of the world, its public sector is a disgrace: inefficient, out of date and, thanks to a plague of initiatives hiving off spending, dangerously unaccountable. Here Mr Schwarzenegger stands on the side of the angels against the public-sector unions; indeed, his reforms should be tougher.

For instance, given the lamentable condition of the state's schools, is it really so heinous to support an initiative to force teachers to work for five years, not two, before they become virtually unsackable? The main sadness is that Mr Schwarzenegger failed to get another measure on the ballot promoting merit pay for teachers (inevitably opposed by the teachers' unions). A second initiative would force the public-sector unions to get written permission to use members' dues for political campaigns—again, surely no bad thing when so much money is in effect just handed to the Democratic Party.

Mr Schwarzenegger's laundry list is not perfect. A third initiative tries to control state spending by a rigid formula, which is usually a mistake. On the other hand, the same measure gives the governor the power to cut spending if no budget is agreed, which would improve accountability. But the main reason for reformers to rally to Mr Schwarzenegger's side is his fourth initiative, which would move authority for drawing political boundaries from the legislature to an independent panel of retired judges.

This may sound like an arcane bit of political procedure, but it could re-energise Californian democracy. At the moment, incumbents from both parties gerrymander districts to protect themselves, squeezing Republicans and Democrats into absurdly shaped districts (see the map in our special report). Last year, not one of the 153 legislative and congressional seats in California changed hands. The state is hardly unusual in this respect; only Iowa and Arizona have fair systems. But it helps explain a good deal of California's political malaise: why so few Californians bother to vote; why they seem more interested in initiatives; and why local parties are so extreme (the only chance of dethroning an incumbent is in the primary, where zealots tend to rule the roost).

The Democrats in the legislature howl that independent redistricting would help the Republicans. In Ohio, where a similar initiative is on the ballot, it is the Republicans who are howling. Both parties miss the point. It is disgraceful, at a time when America is trumpeting democracy overseas, that its own version is so defective. In this as in so many things, the flawed Mr Schwarzenegger is heading in the right direction.

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British politics

Blunkett bows out

Nov 3rd 2005
From The Economist print edition

The prime minister loses an ally—and a little more of his authority

AP

ALL that is best about the Labour Party is to be found in David Blunkett's rise to power. A blind man from a poor background, he reached the top of British politics through ability matched by hard work and a fierce sense of moral purpose. Perhaps that is why his resignation this week as work and pensions secretary after a series of faintly grubby scandals holds such a sorry message. After eight-and-a-half years in office, a whiff of decay hangs over Tony Blair and his colleagues. A party that came to power promising to be different from the shabby and exhausted Tories under John Major now seems rather like its predecessors.

Mr Blunkett's immediate sin was modest but real. As a backbencher earlier this year, he took up three directorships without first alerting an independent parliamentary committee watching over the behaviour of former ministers. But it came after a miserable 18 months in which his liaison with a married magazine publisher became hopelessly mixed up with his political life—an entanglement that undermined his reputation for probity and sound judgment and, last December, cost him his job as home secretary (see article). Mr Blunkett and his supporters have been swift to blame this latest resignation on Britain's predatory media—and the criticism holds some truth, in that recent accounts had lapsed into prurience and unforgivable jibes at the expense of his blindness.

But Mr Blunkett's departure cannot be dismissed so easily. His mistake in ignoring the ministerial code of conduct would have made him less effective in office. That he returned to office so soon and made that mistake feeds doubts about Mr Blair's own judgment and authority. These days, the prime minister faces growing questions about whether he can accomplish the ambitious reforms he pledged in order to get Labour elected in May for a record third term.

Mr Blair is in a hurry. In October last year, a weakened Mr Blair announced that this term as prime minister would be his last and that he would not fight another election. That was an innovation in a political system where leaders go on and on—possibly a foolish one. Although Mr Blair wisely did not say precisely when he would step down, he is now at risk of becoming a lame duck. To prevent this and to secure himself a legacy he has conjured up a whirlwind of domestic reforms in health, education, employment, pensions—anything, in fact, that signals to voters (and his party) that he still has plenty to do and plenty of appetite to get it done.

Mr Blunkett was part of that strategy. He is close to the prime minister and a political fighter of huge experience and energy. He could be counted on to battle for reform of the welfare system and of the mess inside Britain's pensions system (see article) even as other ministers might start to think about preparing for the reign of Gordon Brown, the chancellor and Mr Blair's likely successor. Moreover, the prime minister's momentum has recently been slowed by a row in cabinet disputing his reform of education, by a concession allowing public-sector workers to continue claiming a pension at only 60, and by clumsy attempts to show that he can curb Britons' drunkenness and petty crime.

Lonely Tony

Nobody should write off Mr Blair's premiership yet. If anyone can turn unpredictable events to his advantage, it is he. Besides, he is right to want to deal with Britain's long-term unemployment and to make its hospitals and schools answer to patients and parents. But this will come about only if Mr Blair can regain his authority. Hence he needs a victory in, say, welfare or education. For this, he must rebuild relations with his own party, which is fast developing a taste for rebellion—and almost defeated him this week over anti-terror laws. And that, in turn, means working more closely with Mr Brown, who now more than ever commands the loyalty of MPs.

Co-operation with his rival might come hard to Mr Blair, but it would at least secure some of his agenda. It would also suit Mr Brown, who could win a definite, trouble-free handover of power. Mr Blunkett's fall hints at a dangerous fragility in Mr Blair's third-term government. He needs to repair that—and soon.

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On Alan Greenspan, Airbus, nuclear weapons, the Talmud, cronyism, bird flu, the White House, R&D expenditure, legacy costs

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From Economist.com

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

The political economy

SIR – Ayn Rand's vicar on earth, Alan Greenspan, may deserve to join his guru in her capitalist Valhalla ("A hard act to follow", October 15th). But those who say he is the "greatest central banker ever" are exaggerating their case. He never had to deal with anything like the spiralling inflation that William McChesney Martin and Paul Volcker, his forebears, forcefully brought under control (in this regard, we should remember that suppressing inflation is the Federal Reserve's raison d'être). And claims to greatness become more suspect if we remember the events of 1994. Bill Clinton appeased the bond-market gods by passing a tough tax bill (which also yielded a long string of budget surpluses). But instead of maintaining this policy equilibrium by balancing a tighter fiscal policy with an easier monetary stance, Mr Greenspan doubled the Fed's rate to 6% within a year, undermining the incipient cyclical recovery and providing Newt Gingrich's bomb-throwers with the ammunition to take over Congress. The result is today's stranglehold on government by profligate Republicans.

William Burke
San Francisco

Airbus and Boeing

SIR – Ted Austell, Boeing's vice-president for international trade policy, stated that Nöel Forgeard, EADS co-chief executive, had said the profitability of Airbus would be "destroyed without launch aid" (Letters, October 22nd). This is a gross misrepresentation of the words used by Mr Forgeard and of the position of EADS and Airbus. What Mr Forgeard actually said was that Airbus's profitability would be "destroyed" without a "level playing field" for competition between Airbus and Boeing in the global market for large commercial aircraft. As Mr Forgeard recently remarked at the Confederation of British Industry manufacturer's dinner in Birmingham: "We want to compete on the global marketplace, not in court."

The position of EADS and Airbus is that we would be willing to put all the existing funding arrangements on the table as long as Boeing does the same. We believe that it is in the interests of all parties to agree a workable, transparent and free market in large commercial aircraft programmes. In the end, all of us, aircraft producers and users alike, will benefit from an open and competitive basis for this globally important industry.

Christian Poppe

Senior vice-president for corporate communications, EADS
Munich

Nuclear confusion

SIR – You are right to recognise that the offer from George Bush to help India with nuclear technology is a huge mistake ("Bend them, break them", October 22nd). The biggest problem facing the world is a war resulting from nuclear proliferation. America and Russia have pulled back from the brink, but India and Pakistan have increased the danger and the more nations that have nuclear weapons the greater the probability of war between them. This latest deal exonerates India and undermines the argument that Iran and North Korea should not have nuclear weapons.

Bill Thayer
San Diego, California

SIR – India will comply with international inspection rules when China begins to respect the non-proliferation treaties it has signed. China, by aiding and abetting Pakistan's nuclear proliferation, is waging a proxy nuclear war on India and the West has not lifted a finger to stop it. Do you expect India to sit still while its neighbours march forward with nuclear weapons technology without any guarantees protecting it from nuclear attack? The West has already punished India over the past 31 years and allowed China (the biggest proliferator) to gain a quantum leap in nuclear energy production. Do you still want to tie India's arms behind its back and enable China to increase its economic and military lead?

Vipin Shah
Nairobi, Kenya

SIR – Israel has had nuclear weapons for over 30 years and there has been a conspiracy of silence in the West ever since. Yet when India, a democracy, exploded a bomb, it was deemed to be "naughty" for not living up to the rules of the club. Now, it seems, Mr Bush wants them in the club. No wonder Iran cannot stand the West's hypocrisy.

Gerry Richardson
Pender Island, Canada

Men of the cloth

SIR – You mistook the Talmudic rule that Robert Aumann (and Michael Maschler) were able to explain using game theory (Economics focus, October 15th). The example you gave was how to divide a garment between two claimants (give three-quarters to the person who claims all of it, and a quarter to the person who claims half of it). But the logic behind this rule has always been clear. What Messrs Aumann and Maschler did explain are the Talmud's more esoteric rules on dividing insufficient assets among three creditors. For example, suppose a man dies with 200 dinar to his name, and debts of 100 dinar to one creditor, 200 to another and 300 to the third. The Talmud rules that 50 dinar should be given to the first creditor and 75 each to the other two.

Ron Cohen-Seban
Haifa, Israel

The old school ties

SIR –"Cronyism" has taken a very negative connotation and is now basically used as a synonym for nepotism (Lexington, October 15th). But there are two very different types of the practice: the

Mediterranean type, where you choose someone because he is the friend of your cousin's nephew; and the Anglo-Saxon type where you appoint your friend because you have tested him for decades. Most people may pour scorn on the notion and call it naive, but I hope that there are still some of us left who can admit to something positive in the public-school ideals that built the British empire. In this context, cronyism is simply believing that you have been brought up among the best and the people you've chosen to be your friends are the best. It then follows that if you have been chosen for an important position you would believe that your friends were just as capable. If Waterloo was won on the playing fields of Eton it would make sense to choose an Old Etonian general.

Biagio Mazzi
London

Birds and bugs

SIR – The millennium bug is a poor example of a scare story without foundation ("On a wing and a scare", October 22nd). The threat was real enough, but a lot of effort was expended to ensure there was "hardly a ripple". Precisely the opposite of your point.

Robin Guenier
St Albans, Hertfordshire

SIR – You mention the possibility of avian flu mutating into a form dangerous to humans. I feel you are taking sides with evolutionist interpretations and discarding the perspective of intelligent design. If the virus develops a new form to propagate among humans, where before there was none, a designer (who enjoys tinkering with the machinery of death) might have decided to add this capability.

Alfonso Martinez
Amsterdam

ONLINE ARTICLES

The following correspondence refers to articles published only online

The White House under siege

SIR - In your article "Indictment reaches the White House" (Economist.com, October 28th) you blithely ignore the heart of the matter: the creation of a web of lies and distortions for which thousands of human lives have been wasted. Such ignorance indicates that you feel, as do Messrs Bush, Cheney, Rove, Libby and Wolfowitz, that ends justify means and that distortion and dishonesty are truly the prerogatives of power. That's the real indictment.

James Talley

European R&D

SIR - R&D is not an end in itself, but a relatively small element in innovation ("When growth and social protections clash", Economist.com, October 27th). Firms tend to do R&D up to the point at which the risk-adjusted expected rate of return equates to that on other expenditure; and that return depends on the ability to turn R&D into commercially viable innovation. So long as European Union countries lag behind in providing an environment conducive to entrepreneurship,

relative R&D expenditure will, and should, lag far behind that in America. President Jacques Chirac's call for increased R&D investment is just another attempt to put off the serious economic reforms required for innovation-driven growth.

Michael Cunningham

Buttonwood on Delphi, GM and legacy costs

SIR - Buttonwood provided us with quite a fair round-up of the Delphi/GM mess, especially with regard to pension promises and obscene medical-insurance costs. But again, the blame is placed squarely upon the unions as the negotiators of such sweet benefits. I wonder where in all of this is the responsibility of the past management, who time and again took the path of least resistance and stupidly allowed the unions to wreak their havoc? Doesn't the other side of the table share in the responsibility for this economic mess? The executive class deserves to be stoned along with the unionists.

When the dust settles, the surviving workers will still have a salary, albeit smaller; the managers will still have their bloated salaries and bonuses, and the losers will be the taxpayers then burdened with the abandoned pension systems of both Delphi and GM. That's the American way.

Joseph Bennett

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Schwarzenegger's California

Blowing up the boxes

Nov 3rd 2005 | LOS ANGELES
From The Economist print edition

Getty Images

The governor's proposals are his best chance to do something positive for the state—and for his own battered reputation

Get article background

SERIOUS and sombre, Governor Arnold Schwarzenegger stares out from the TV screen. “Two years ago you elected me to change Sacramento and put California back on track. I've had a lot to learn and sometimes I learned the hard way.” The Gubernator seems gentler, modest even, and no wonder. He has been humbled by approval ratings that, in less than a year, have plummeted from the stratospheric to the dismal. “But my heart is in this and I want to do right by you,” he continues, plangently. “We will either shape the future or suffer it. Give me the tools to do the job you elected me to do, so we can build a better California.”

The “tools” Mr Schwarzenegger means are four propositions that will appear on the ballot in California's “special election” on November 8th. One hits out at the teachers' unions; a second bashes the public-employee unions in general; a third gives the governor power to cut spending without the legislature's permission; and a fourth is designed to stop gerrymandering, or the redrawing of district boundaries for political advantage. If all these were passed, as Mr Schwarzenegger hopes, California's public schools would no longer be among the worst in the country; lawmakers in Sacramento would not be divided by partisan extremism; and the state's budget would no longer carry a structural deficit of about $6 billion for the next financial year, on a budget of $113 billion.

But will those electors who bother to vote (voting being tepid in these parts) do his bidding? At stake is not just the immediate future of America's most populous and most emulated state, but Mr Schwarzenegger's future, too—and, by implication, that of his party. After all, the body-builder-turned politician by way of Hollywood was the star of the Republican convention last year: an electorally invincible mix of charm and muscle, part social moderate, part fiscal conservative.

No longer. A new poll by the Public Policy Institute of California (PPIC) shows the governor's approval rating at a mere 33%, with just 12% of Democrats giving him good marks. In liberal-leaning California, where 43% of registered voters are Democrats and 34% Republicans, Mr Schwarzenegger has moved so far to the right that one Hollywood leftie, Warren Beatty, has called him a “Bush Republican”. He has even blunted his best weapon, his direct popular appeal, by appearing to deride the state's nurses, firemen and teachers, all of them more popular than any politician.

Yet it is hard to argue with the governor's basic premise. California's government is in urgent need of reform. It is too often gridlocked, pandering to the extremes on both sides of the political aisle. But it is equally stymied by voters' addiction to direct democracy and its ballot initiatives, the very tools that the governor is wielding in the special election.

Vox populi, pox populi

When Arnold's political hero, Governor Hiram Johnson, added direct democracy to the California constitution in 1911, the idea was to let citizens circumvent any legislature on the rare occasions when it ignored the will of the people. Rare indeed: from 1912 to 1978, only 46 initiatives were passed. Since then, lured by rich lobbies using paid signature-gatherers, voters have been tempted with hundreds more, including the one that indirectly brought Mr Schwarzenegger to Sacramento.

The problem with this surge of popular will is that ballot initiatives, exempt from the refining touches of the legislative process, can have unintended consequences. A prime example in California is Proposition 13, handsomely passed by the voters in 1978. This limits property tax to 1% of a home's purchase price and restricts the increase in valuation to 2% a year until its next sale. Moreover, to set the benefit in stone, Proposition 13 also rules that any new taxes require a two-thirds vote by state and local legislatures. One result has been to starve local governments of revenue and to make them dependent on the state. Another is to let many a Bel Air plutocrat pay a relative pittance in taxes on his gated estate. Yet so popular is the proposition that no politician dare challenge it. When Warren Buffett, the world's second-richest man and then a Schwarzenegger adviser, suggested it be revised, the governor threatened to make him do 500 sit-ups.

The state, too, gets hamstrung. Proposition 98, passed in 1988, requires that 40% of the state's general fund (which makes up four-fifths of the total state budget) be spent on primary and secondary schooling, and that the sum should grow each year in tandem with the economy and the number of students; Proposition 42, passed in 2002, dedicates the sales tax on petrol to transport projects. When all such initiatives are added together, the politicians in Sacramento find that around 70% of the general fund is off-limits.

He has gradually fallen into a trap laid for him by the Democrats—and allowed himself to be depicted less as a reformer and more as a Republican partisan

Cynics might say that that is just as well. Sacramento's full-time lawmakers—40 in the Senate and 80 in the Assembly—tend to give politics a bad name. Almost every year the budget is agreed many weeks after its supposed June 15th deadline; this year's, relatively

snappy, was only three weeks late. A two-thirds majority in each house is required to pass a budget, and there are enough tax-cutting Republicans to block the tax-and-spend Democratic majority. Making matters still more difficult, gerrymandered districts favour not moderates but those extremists who can appeal to the party activists: of the 153 congressional and legislative seats up for election a year ago, not one changed hands. The governor's approval rating may be low, but the legislature's is even lower: just 25%, according to the PPIC poll.

Dr Arnold's prescription

But is the need to reform this mess so urgent that California must have an expensive special election? For all the deficiencies of its politics, California's economy (the eighth-biggest in the world last year) is at present robust enough. After Texas, it is America's largest exporter, with sales abroad—from Palo Alto's computer software to the fruits of the Central Valley—growing last year by 17%. The Milken Institute reckons that California is the nation's fourth-most-costly state for doing business, but adds that it is first in jobs created by new companies. Even the notion that businesses are deserting California for cheaper states is doubtful: a recent study by PPIC concluded that only 1.6% of the jobs lost between 1992 and 2002 came about because businesses had fled. Why not, therefore, simply wait until next year's regular election, and so save around $55m?

The Schwarzenegger answer is that if you break your arm, you don't wait around before you fix it. In this case, the broken arm is the perennial budget deficit and the power of “special interests”, by which he means public-employee trade unions rather than his own, extremely generous, corporate donors. And, to stretch the medical metaphor, the longer you wait, the worse the damage.

He has a point. California's budget problems stem from the gung-ho days of the dotcom boom, when buoyant tax revenues fed into extra money for schools and extra pay and benefits for public employees. When the boom abruptly faded in 2001, too much of the state's spending remained on what Mr Schwarzenegger calls “automatic pilot”, mandated to increase even when revenues did not. The state's pension obligations, for example, have soared from $160m in 2000 to $2.6 billion this year. Tom Campbell, the governor's finance director, says ruefully that if spending had risen from its 1999 level merely at the pace of economic growth and inflation, California's budgets would have stayed in balance.

Body-building programme

Proposition 74	Teachers' probationary period, during which they can be fired without a hearing, extended from two years to five. Dismissal process for tenured teachers simplified.
Proposition 75	Public-employee unions required to get members' written consent to use dues for political campaigns, including initiatives.
Proposition 76	Limits state spending to prior year's plus the average revenue increase of previous three years. Changes state minimum school-funding requirements (Proposition 98). Gives governor power to make mid-year spending cuts in certain circumstances.
Proposition 77	Redistricting authority shifted to panel of three retired judges. New districts would be redrawn immediately, and subsequently after each national census.

Sources: California Secretary of State's Office; *USA Today*

Nor is this the only reason for Californians to worry. Steve Westly, the state's financial controller (and a Democratic candidate for governor in next year's election), bemoans the “bar-bell” society. There are plenty of well-paid jobs again, he says, for the brainy types in the Bay Area, and plenty of unskilled jobs everywhere for ill-educated Latinos, but a painful squeeze for the middle class, striving to be home-owners in a state where the median price for a single-family home has doubled in the past five years to more than $450,000. Add in the cost of health care (premiums in the private sector rose by over 11% last year) and rising fees for college, and the average Californian, if there is such a type, is feeling grossly overburdened.

But how much of that is within the power of even the Gubernator to correct? Part of California's

problem is simply that it has become the victim of its own success. So many newcomers chase the California dream (sun, surf and swimming pools, with money to spare) that population growth is outstripping the state's ability to cope. There are not enough roads, buses, power plants or nurses; there is too much sprawl and pollution. Los Angeles now spreads eastwards with scarcely a break to the new towns of the “Inland Empire”; pollution clouds the air even in the farmlands of the Central Valley.

The problem is not unlike Gold Rush days, but with far larger numbers. In 1970, California's population was around 20m. Now it is 36m—including 2.6m illegal residents, most of them from Mexico—and by 2030 it could be 50m. By then the state's Latinos, at present a third of the population, will outnumber non-Hispanic whites.

That should be a boon: a young tax-paying workforce over time gives more to the economy than it takes out in public services. But that is not how a lot of Californians, especially white “Anglos”, see it: they complain that Spanish-speaking schoolchildren lower standards in the classroom and that poor, uninsured immigrants put an unfair demand on health care that has to be paid either by the state or in extra health premiums for everyone else. That was why Californians voted in 1994 for Proposition 187, a measure—later blocked by the courts—that banned undocumented immigrants from public benefits such as education, welfare and health care. Mr Schwarzenegger, too, voted for it. Today he vetoes bills that would allow illegal immigrants to have driving licences and compliments California's self-styled “Minutemen” when they ostentatiously pack guns along the border with Mexico to deter illegal immigrants.

That could be a political mistake. The backlash, especially among Latino voters, against the Republican-backed 187 is one reason for the present Democratic dominance in the state. On the other hand, some scholars believe that white Californians will continue to be a majority of actual voters even as the white share of the population dwindles to a third by 2040. In the meantime, the governor's approval rating among Latinos is a derisory 16%.

Elusive victory

So is Mr Schwarzenegger's plan for reform destined to fail? The answer depends partly on how you define success. He once swore to “blow up the boxes” of government, and last year he commissioned a “California Performance Review” to help him. That review, complete with more than 1,200 recommendations, supposedly found ways to cut state spending by $32 billion over the next five years. But relatively few of the recommendations have been implemented. The review also said nothing about changing the two-thirds rule for budget approval by the legislature, or re-

visiting Proposition 13. In other words, the boxes are still intact.

Nor is it clear that the governor has chosen the right propositions. Originally, he wanted to privatise the pensions of state employees, moving them from guaranteed benefits to ones dependent on the fortunes of the market. That money-saving proposition had to be abandoned when the state attorney-general, a Democrat, ruled that it would eliminate the death and disability benefits paid to policemen and firemen and their families. Similarly, a proposal to reward good teachers with merit pay had to be junked when not enough signatures were gathered.

In the end, success or failure may depend on turnout

The four tools he is left with are controversial. Proposition 77, which would outlaw gerrymandering, is reviled by the Democrats as “a Republican power-grab”—though it could also be a Democratic one. A constitutional amendment, it calls for redistricting to be taken away from the lawmakers (whose efforts may be admired in the map above) and handed to a panel of three independent, retired judges. There is evidence that it can work. After Pete Wilson, a Republican governor, vetoed a Democratic-imposed redistricting plan in 1991, the California Supreme Court stepped in to appoint “special masters” to draw up new boundaries, and their work produced real competition in the elections held from 1992 to 2000. Yet only 36% of those in the PPIC poll support the idea.

There is still less public enthusiasm for Proposition 76, the “Live Within Our Means Act”. This would limit state spending to the previous year's amount plus the average revenue growth of the previous three years, with any excess revenue going into a “rainy day” fund. Moreover, if the budget lurches into deficit during the financial year, the legislature has 45 days to put it right, after which the governor has the power to make spending cuts across the board. (Raise taxes? Gott forbid.)

All that seems sensible enough. Thirty-six states require a mid-year correction if a budget goes horribly astray; and, when their legislatures fail to co-operate, seven governors already have the kind of power Mr Schwarzenegger is seeking. But Proposition 76 also touches the “third rail” of California's budgetary politics: it messes with the education-funding guarantees of Proposition 98. At the moment, when the state provides funding above the minimum guarantee, the extra money becomes part of the base level for future years. Under Proposition 76, this ratchet effect would be eliminated. But since Mr Schwarzenegger had already last year “borrowed” $2 billion due to the schools under Proposition 98, the teachers' unions (and plenty of parents) accuse the governor of reneging on his debts and short-changing California's children.

Ironically, the governor seems more in touch with public opinion when he attacks the unions head on. According to the PPIC poll, sentiment among likely voters is equally divided, 46% to 46%, on Proposition 75, which requires public labour unions to get consent from employees before using their dues for political purposes. Opinion is similarly balanced—46% for and 48% against—on Proposition 74, requiring a teacher to work successfully for five years, not two, before being confirmed in the job. The unions have spent massively to defeat both propositions.

In the end, success or failure may depend on turnout. The theory is that Republicans may be motivated to go to the polls by Proposition 73, which would require a doctor to notify a parent before carrying out an abortion for a minor. Since Mr Schwarzenegger has endorsed 73, a vote for it could well become a vote for his four propositions, too. But if turnout is high, with many Democrats voting, the governor may be lucky to get anything through.

And what then? Doubtless the positive-thinking Mr Schwarzenegger would find some way of declaring the result “fantastic”—his favourite word—but he would be politically weakened. Democrats such as Mr Westly and Phil Angelides, the state treasurer, would think they had a real shot at toppling the governor in a year's time; the lawmakers would see no need to compromise,

either with each other or with the governor; and, worst of all, a chance to blow up at least some of the boxes would have been squandered.

For that, the governor will clearly blame “special interests”. Yet the real culprit is arguably Arnold himself. His electoral strength in a left-leaning state has always come from seeming independent, reaching out to Democrats and Republicans alike. His reward for this approach in March last year was the passing, against the odds, of two propositions that allowed the state to borrow another $15 billion while also requiring the lawmakers to make better efforts to balance the budget. Yet this year, he has gradually fallen into a trap laid for him by the Democrats—and allowed himself to be depicted less as a reformer and more as a Republican partisan.

Perhaps this was inevitable. Since the public-sector unions were pouring out money to disparage him, Mr Schwarzenegger had to turn to the right to raise money to fight back. He was slow, too, to come out from behind his Hollywood handlers and defend his record in public; he did not start to fight back until last month. If he pulls off a comeback in the last reel and wins next week, there will be room for him to return to a broader reform programme. If he loses, he could rue the past 12 months. And so could a state for whom this unlikely figure still offers the best chance of reform.

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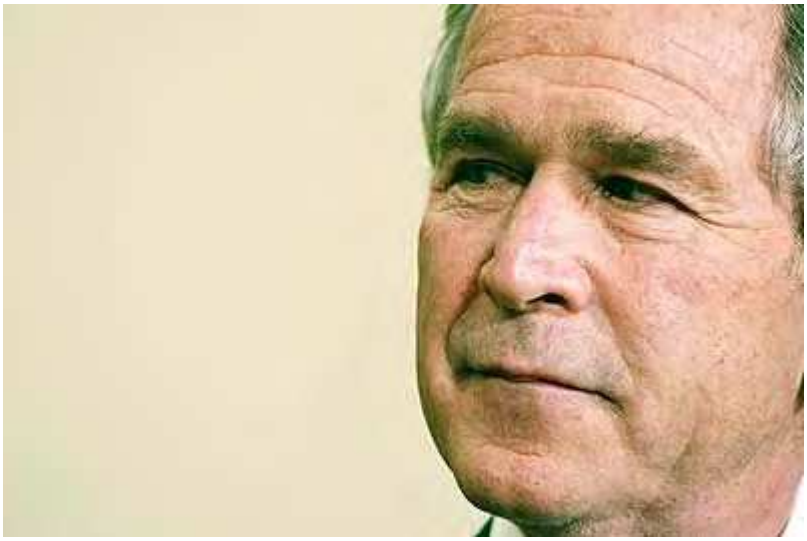
George Bush at bay

The long, hard road to recovery

Nov 3rd 2005 | WASHINGTON, DC
From The Economist print edition

Getty Images



The president has begun to repair his relations with his conservative base; now he may have to sort out his inner circle in the White House

Get article background

YOU can tell that you're having a bad week in politics when your smartest move is to ask your own nominee to the Supreme Court to withdraw her name. You can tell that you're having a really bad week when the best news is that only one of your senior aides has been indicted.

The week that ended on October 28th was the most miserable of George Bush's presidency. It not only saw the ignominious withdrawal of Harriet Miers's candidacy for the Supreme Court but also the indictment on five counts of perjury, making false statements and obstruction of justice of the vice-president's chief of staff, “Scooter” Libby, a man who exercised so much influence in the White House that he was known as “Dick Cheney's Dick Cheney”. And those are only the self-inflicted wounds: add in the news of the 2,000th American death in Iraq, and you can see why the mood in the White House was a cocktail of depression and panic.

Mr Bush's dreadful week came at the end of a couple of dreadful months. His second-term agenda—particularly his plan to reform the Social Security pension system—has fizzled rather than flamed. His political team has been listless and gaff-prone. And his personal response to Hurricane Katrina was a disgrace. The cumulative effect of all these mistakes was to erode the two pillars upon which he has built his presidency.

The first pillar is the Hamiltonian one of the “energetic executive”. Team Bush has always believed that the government can work only if the White House fiercely asserts its power. From the start Mr Bush was an activist president, rolling out tax cuts, education reforms and, in the wake of September 11th, a global war on terror.

But sometime in his second term the Bush executive ran out of energy. There are lots of reasons for this. Mr Bush squandered a pile of political capital—and personal time—on a cause that never caught fire, Social Security. Patrick Fitzgerald's inquiry into the leaking of the identity of a CIA agent, Valerie Plame, distracted and demoralised the White House, especially when it ensnared Karl Rove, Mr Bush's main adviser.

Yet there may also be something deeper at work. Mr Bush's listless response to Katrina revealed a president who was out of touch—a man so surrounded by sycophants and faint-hearts that he didn't learn that New Orleans was sinking until it was too late. You can't have an energetic, engaged executive unless you have an energetic, engaged chief executive.

The second pillar of the Bush presidency was the Roveian one of “the politics of polarisation”. Messrs Bush and Rove have been at their most successful when playing political hardball: mobilising the right, winning over a sliver of conservative Democrats and independents, and driving left-wingers to derangement. This was the formula that produced their triumphant 51%-48% victory last year.

But recently Mr Bush seems to have forgotten that you can't play hardball during elections and then revert to softball the rest of the time. His choice of Ms Miers—a nice but ineffectual woman of no fixed views—led to an open revolt from Mr Bush's base. Conservatives had been willing to tolerate Mr Bush's deviations from the path of orthodoxy over government spending and the educational bureaucracy as a necessary price for wooing suburban voters. But they expected Mr Bush to honour his election promise to appoint a Supreme Court justice in the mould of an Antonin Scalia or a Clarence Thomas. His refusal to do so infuriated them.

Can Mr Bush rebuild these two pillars of his presidency? It won't be easy. Mr Libby's indictment is an embarrassment to the White House—and it will grow as Mr Libby goes on trial and as senior figures in the press and the administration, perhaps including Mr Cheney, are asked to testify. It has also reportedly caused tensions between Mr Bush and Mr Cheney.

The Harriet Miers debacle has weakened the special relationship between Mr Bush and the conservatives. The president is apparently furious about being bullied by the right, and the right is much warier of Mr Bush. Indeed, relations were already strained. Karlyn Bowman of the American Enterprise Institute has found that, two years ago, 82% of conservatives approved of Mr Bush. In the third quarter of this year, only 69% did.

Two new issues could cause further tension on the right. The first is immigration reform, which divides Republicans more than any other issue, pitting libertarians against nationalists, business conservatives against blue-collar conservatives, and economic conservatives against populists. The second is spending cuts. The Republicans have been highly successful in holding their caucus together in Congress while they were throwing money at bridges to nowhere in Alaska. But can they preserve the same discipline now they must cut spending?

Most worrying of all, Mr Bush's fortunes for the rest of his second term are tied to events in Iraq—events over which he has little direct control and which tend to capture popular interest only when they go badly. Bombs are always more newsworthy than ballots: the *Washington Post* published news of the 2,000th American death on its front page but buried news of the Iraqi referendum on page 13.

Yet Mr Bush's week from hell actually contained two important bits of good news. First, if Mr Fitzgerald's carefully worded speech has been decoded properly by legal analysts, it looks as if Mr Rove has probably escaped indictment. The White House can live without Mr Libby. But Mr Rove is the most powerful presidential adviser in recent history: a man who combines a strong political vision (creating a Republican majority) with an unparalleled knowledge of political mechanics. His apparent survival lifted a pall from the White House and sent a surge of energy through conservative America.

The second bit of good news is that Harriet Miers's withdrawal provided Mr Bush with an opportunity to choose a more appropriate candidate. Samuel Alito, an intellectually distinguished staunch conservative, has won Mr Bush more credit with his base. (Bill Kristol at the *Weekly Standard* argues that the “foul ball” of the Miers nomination was followed by the “home run” of the Alito nomination.) Rather than sniping at the Bush dynasty, conservatives can do what they like doing most—savaging liberals (see article).

Mr Bush has time on his side. Although the Plame affair has tarnished his reputation for honesty with independents, it has hit him in the first year of his second term, allowing him to recover. By contrast, the Iran-contra affair hit Ronald Reagan (who was already old and distracted) in the second year. The Lewinsky affair hit Bill Clinton at a similar time, after a run of other bits of sexy, sleazy business.

This time, the Republicans face some nasty scandals in Congress, but Mr Bush's White House has been relatively untouched by them. The Democrats will try to keep the Plame affair in the headlines. This week they forced the Senate to have a special closed session to study evidence about the pre-war case for the Iraq conflict (a rarely invoked measure). But without a Rove indictment, the affair looks unlikely to mutate in the way the left hopes.

Mr Fitzgerald indicted Mr Libby on technicalities rather than the main crime (outing a CIA agent). And the whole affair has an oppressively inside-the-Beltway feel: this Sunday, one TV journalist, Tim Russert, was reduced to chatting with his fellow pundits about his own role in the whole affair. Enough, already.

Things can only get better?

As for the economy, despite all those worries about imbalances output has grown at an annual rate of 3% or more in each of the past ten quarters. Conservatives say that this proves that Mr Bush's tax cuts were exactly the right remedy for the American economy. Of course, there are all sort of clouds on the horizon, including the spectre of a slowdown in the housing market. But, for the moment at least, a buoyant economy provides a reason for conservative America to forgive Mr Bush all those spending increases.

None of this adds up to an automatic revival in Mr Bush's fortunes. Throwing red meat to his supporters will not help much if he does not recover his reputation for competence. The nomination of Ben Bernanke to replace Alan Greenspan as Federal Reserve chairman was a step in the right direction. Another, arguably, was Mr Bush's decision to lavish $7.1 billion on preparing for a bird-flu pandemic.

Mr Bush surely needs to shake up the White House. Mr Rove's problems with Mr Fitzgerald (coupled with the fact that he was in hospital when Katrina struck) showed the inadequacy of the White House's reserve team. Some of Mr Bush's more brutal supporters want to move his chief of staff, Andrew Card, to the Treasury. Others want to replace Scott McClellan with a more dynamic spokesman. And a few even ask pointed questions about the blundering Mr Cheney—though the vice-president remains hugely popular with the conservative base.

If Mr Bush can seize the moment, he can turn his second term round. If he dithers, as he did during Katrina, things will get a lot worse.

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Texas's dangerous churches

The faithful on the front-line

Nov 3rd 2005 | AUSTIN
From The Economist print edition

Surely not what the Good Lord intended

AP

Kyle the Baptist

Get article background

BAPTISM, the Christian act of dipping people (usually tiny ones) in water to erase the effects of original sin, is known to be dangerous. Babies are sometimes almost drowned. Earlier this year a baptism at sea took the lives of five South Africans. Now the rite appears perilous for baptisers too. On October 30th Kyle Lake, a pastor at a Baptist church in Waco, Texas, collapsed at the water tank in front of 800 of his horrified flock. Mr Lake apparently grabbed the microphone while he was in the water—and was promptly electrocuted. The woman he had just baptised was unhurt.

Texas's megachurches are famous for their pioneering use of technology: many resemble electronics fairs, with computers, video screens and in-house studios. Several have chief technology officers. Most pastors wear wireless, battery-powered mikes inside their rubber waders precisely to prevent the sort of mishap that killed Mr Lake.

Worshippers in the state are prone to horrifying incidents—most famously the explosion at the Davidians' besieged compound in 1993. In 1999, seven churchgoers were shot dead by an obscenity-screaming madman in Fort Worth, who then killed himself. On a lesser scale, a row broke out in Austin two months ago after a Catholic priest pricked the fingers of more than a dozen children during Mass with an unsterilised pin. The idea was to show the pain that Christ must have suffered on the cross. The priest claimed to have drawn no blood, but parents still howled about possible HIV and hepatitis.

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Foreign aid

Pro Bono

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Setting up an "NRA for the poor"

AT A recent U2 concert in Washington, Bono ordered up "a Milky Way". Thousands of fans whipped out mobile telephones and lit up the darkened stadium with illuminated screens. The singer then suggested that everyone call a congressman to demand more aid for Africa. Or, he said, they could join "One", his new anti-poverty movement, by sending a text message.

One is an attempt to build a "National Rifle Association for the poor". Not because destitute Africans need more guns, but because, unlike local gun-owners, they lack an effective lobby. America is exceptional among rich countries in this respect. For example, thanks to concerted drum-beating by charities, British people deluge their politicians with postcards and phone calls demanding more overseas aid.

It seems to have an effect. Britain's aid budget in 2003 was 0.34% of GDP; America's is only 0.15% (with a chunk of that going to Israel and Egypt). The average in Europe is around 0.4% of GDP (with Norway giving 0.92%). To be fair, American individuals are big givers (witness the generosity of Bill Gates and many American churches). But One's backers think a grass-roots movement could gather in public money too.

The plan is to reach out both to bleeding-heart liberals and to the religious right. One's first ad included not only Tinseltown lefties such as George Clooney but also the ultra-conservative preacher Pat Robertson. Hours before his concert, Bono sat down for a long chat with George Bush. And the aim is not to raise cash directly, but to push Congress to take account of the interests of the world's poorest.

One's list of members (ie, people who have volunteered their e-mail addresses) has grown to 1.6m since May 2004. (The NRA has more than 4m paid-up members.) Before the G8 summit in July, One's members sent half a million e-mails to the White House urging more aid, more action against AIDS, fewer farm subsidies, and so on.

Will the momentum be sustained? Those who think aid fosters dependency and corruption will never come on board, and those who object to One's woolly advocacy of "fair" rather than free trade will hesitate. But rock stars and preachers can make a lot of congressional telephones ring on a relatively small budget.

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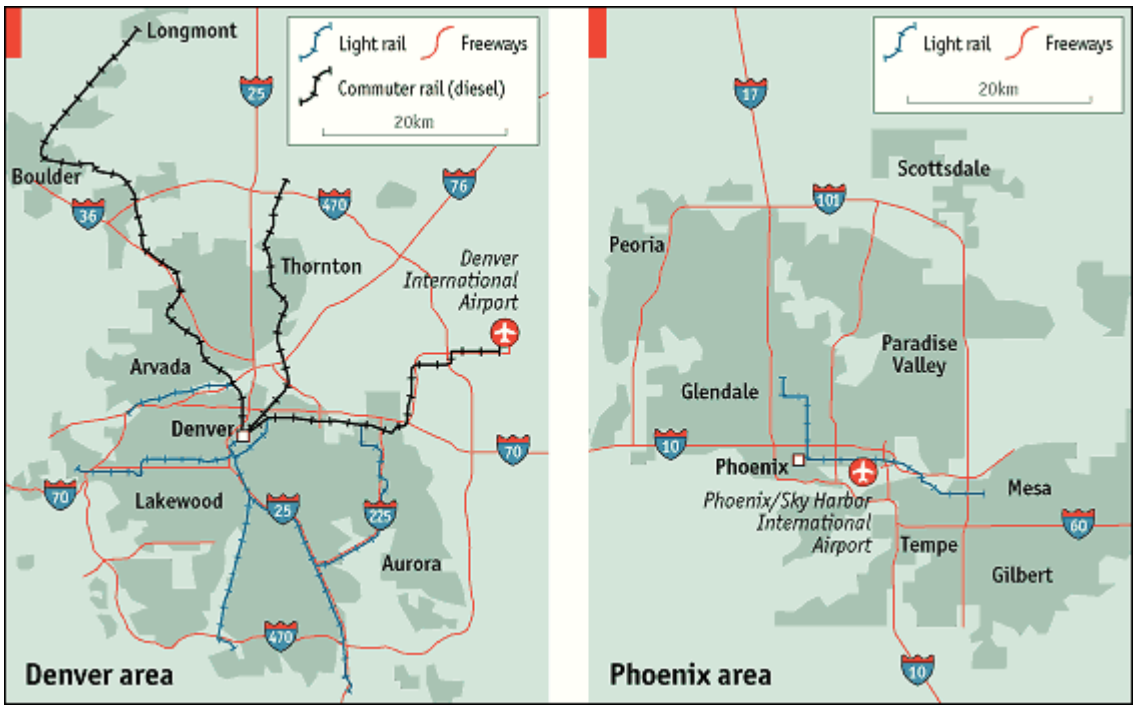
Western sprawl

The octopus and the tortoise

Nov 3rd 2005 | DENVER AND PHOENIX
From The Economist print edition



Can a light-rail system work in the booming west?

"GO WEST, young man," Horace Greeley, editor of the *New York Tribune*, was wont to say, "and grow up with the country." Thousands of Americans still take that advice. Every year, they grab a U-Haul truck and, in the words of one urban planner, "drive till you qualify" for an affordable suburban house.

The western half of America contains most of its fastest-growing cities; but the sprawl also causes problems. One is resentment against oversized McMansions (see article). But the main bugbear for most people is traffic. Can cities built around the car find a better way to organise themselves? Consider the very different approaches of two of the new West's main entrepôts—Phoenix and Denver.

Both are growing at a staggering rate. Since 1960 the population of the greater Phoenix area has grown from 664,000 to 3.6m, an average of 47% in each decade. The population of the Denver metropolitan area has risen to 2.6m, an increase of over 8% since 2000. Inevitably, that means snarled rush-hour traffic. The number-crunchers at the Texas Transportation Institute reckon that in 2003 the average commuter on Denver's roads suffered congestion delays of 51 hours, the 13th-worst in the country. In Phoenix the hold-ups and traffic crawls were almost as bad: 49

hours in 2003, or 18th-worst.

As their rankings imply, Denver and Phoenix still do relatively well compared with many big cities on the east coast or in chaotic California. But that does not stop their residents, many of whom left places like Los Angeles-Long Beach (first in terms of queues) or San Francisco-Oakland (second), complaining about it.

Denver's solution is the bolder. New roads, such as the 47-mile (76km) E-470 tollway, which opened in 2003 along the eastern edge of the Denver region, will form a beltway—75% complete—to relieve congestion in the centre. By the end of next year, the T-Rex scheme, budgeted at $1.7 billion, will have added extra lanes along the I-25 and I-225 freeways.

But the main focus is light rail. T-Rex will stretch 19 miles of new double-track light rail from the Denver city centre to the metro region's south-eastern border. By 2016, a $4.7 billion project known as FasTracks will add another 119 miles of light and commuter rail and some 18 miles of rapid transit by bus. These new lines will curl out from Denver's Union Station like the legs of an octopus, linking up with existing bus services and giving commuters a mass transit alternative to the clogged lanes of the I-25 or US-36.

FasTracks, say its boosters, will be the biggest “build out” of a mass transit system since Washington, DC, began its Metro system in 1976. The aim of FasTracks is not just to ease traffic congestion, but to change the shape of the city. Each station will be the centre of various commercial and residential developments; Union Station will, in the ghastly jargon of urban planning, become a multi-modal hub for everything from buses and heavy rail to the “downtown circulator” that shuttles passengers around the tourist-friendly 16th Street Mall. Instead of simply sprawling ever farther across the mile-high plains, Denver would bring its population closer together.

Pie in the planning sky? Sceptics (including, ironically, Colorado's transport secretary) foresee parking problems at the stations. They also worry that car drivers will ignore light rail (as in Los Angeles) and that the hoped-for offices, hotels and apartments along the FasTracks routes just won't happen. All the same, last November, 58% of metro Denver's voters agreed to back FasTracks with a 0.4 cent sales tax.

For Denver, this is something of a return to its past. Founded in the 19th-century mining boom, it still has roots in the age of rail: witness Union Station and the passenger and freight trains that roll in and out of the city. By contrast, Phoenix lost its passenger train service in 1996, making it possibly the world's largest urban centre without a rail connection for residents. It is a car city—and seems keen to remain so.

In theory, a determined Phoenician could get just about anywhere in the area by public transport. In practice, they made only 12.7 bus trips each in 2002, compared with 37.1 transit trips for the average Denverite (and 28.4 for the average American). Phoenix's voters, by approving in November a 20-year extension for the half-cent sales tax devoted to transport, are also investing in a light-rail system—but just 20 miles of it, to be laid by the end of 2008, plus another 38 to be finished by 2026.

By contrast, the city's main strategy is to lay tarmac. It plans to add 1,328 new lane-miles to its 2,000 mile freeway system over the next 20 years, after adding 982 new lane-miles over the past two decades.

Who is taking the right course? At first sight, Phoenix would seem to have public sentiment on its side. Given a choice, most Americans, especially those in the west, prefer the car, with its promise of comfort, flexibility and freedom. Denver, though smaller than Phoenix, also has the greater

problem to solve: longer rush-hours, more congestion and more wasted time and fuel per traveller. According to the Texas Transportation Institute, its congestion cost per peak-time traveller in Denver was $865 in 2003, compared with $831 in Phoenix.

On the other hand, the centre of Denver is already a more vibrant place than Phoenix—and that gulf is likely to grow. Officials in Phoenix talk bravely of new construction along Central Avenue, which has seen no new high-rise office building since 1991, and of linking the downtown eastward to the university quarter in Tempe. But it looks half-hearted.

Denver's dreams may come to nothing. But Phoenix risks becoming a second Los Angeles—another car-choked city that could never really bring itself to believe in public transport.

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McMansions

Not in my neighbourhood

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Monstrosities, or just monsters?

“THIS I would regard as a very polite mega-house,” says Ken Lampton, a Dallas realtor (estate agent). The house in question, built in the past few years, has the arched doorways and brick-and-stone-façade that mark many of the new mansions in the Lakewood neighbourhood. It is about 3,000 square feet (279 square metres), Mr Lampton reckons, roughly double the size of the area's original houses, which were built half a century ago. Its redeeming feature is that the garage is at the back, rather than the front. Its width is also tastefully shrouded by greenery.

Driving through Lakewood is an eye-opening experience. On some streets, every fourth or fifth house has been torn up and replaced by a “McMansion”. A few are so big that they barely have a garden at all. Some of the modest original houses, priced in the low $200,000s, are surrounded by new $700,000 monsters. Scaffolding, plaster and other signs of construction are everywhere.

Many Lakewood residents are fed up. “When I bought a home here, I bought into a neighbourhood that had trees, that had houses with certain setbacks, that had mostly one-storey homes,” says Wendy Segrest, who moved to Lakewood just a year ago. Now, a 4,500-square-foot mansion—three times the size of her home—has gone up next door, with seven trees bulldozed to make way for it. Ms Segrest worries that her house has been reduced to its value as a vacant lot. “If I were to sell right now, I don't know if I could get somebody other than a builder to buy it,” she says.

Ms Segrest has planted a few “Don't Supersize Dallas!” signs in her front yard. She and other residents have appealed to the local government for help. They emphasise that they are not against construction, but simply want the new houses to fit in better. The city council is currently considering a measure allowing neighbours a say about what new houses in their area should look like. For example, if a majority agreed, they could specify limits for height, garage (at the back, please) and how far the house is set back from the street and from neighbouring lots. A vote is scheduled for November 9th.

Most property people (with the exception of Mr Lampton) are aghast at the idea of any such restrictions. McMansions are “market-driven. It's what the consumer wants,” says Peter Urrutia, director of government affairs for a Dallas-based realtors' association. The idea of “a few individuals deciding what you can or cannot do with your property” is a fundamental issue of property rights.

That is a powerful rallying call in the sprawling suburbs of the South and the west. In most of the battles between growth and nimbyism (not in my backyard), growth has won. But Dallas is not alone in spurring wars about the disproportionate size of some buildings.

Houses across the country are getting bigger: the national average now stands at 2,349 square feet, a 12% increase from ten years ago, though the spurt has slowed in recent years. Some new

palaces are close to 20,000 square feet. And from Queens to Salt Lake City efforts are afoot to change zoning rules to limit sizes.

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Lexington

How to skin a cat

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For activists on both sides, the bloodier a Supreme Court battle, the better

TEXANS have a nice bit of folk wisdom about skinning cats: if you can do it without splattering blood all over the walls, then so much the better. George Bush tried to follow this path with his first two Supreme Court nominations, choosing people with no record for anyone to fight over. He did it so successfully in the case of John Roberts (a conservative who had apparently never said anything) that Democrats were left agog at his bloodless knifework; but when he tried to repeat the trick with his own lawyer, Harriet Miers, he missed the cat entirely and stabbed himself. Now, with Samuel Alito, a chastened president is trying exactly the opposite strategy: skinning the cat with a view to getting as much blood on the walls as possible.

Mr Bush's new pick for the court is a darling of the conservative movement. When news of his appointment this week reached one gathering of the tribe in California, the faithful reacted in much the same way as normal people would do to news that they have won the lottery. Unlike Mr Roberts, Mr Alito has a long track record: in his 15 years sitting on the Third Circuit Court of Appeals he has written more than 240 opinions, including 41 dissents. He has supported the display of religious symbols on government property and expanding the right of police to conduct searches. In *Planned Parenthood v Casey* (1992) he argued that the state could require married women to notify their husbands before obtaining an abortion. In his dissent in *US v Rybar* (1996) he argued that Congress doesn't have the power to use the commerce clause to ban people from owning machineguns.

As if this wasn't enough to guarantee fisticuffs at his confirmation hearings, Mr Alito is being nominated to take Sandra Day O'Connor's place. For the past 24 years, she has been the swing

vote, voting overwhelmingly on the left on social issues and generally on the right on economic ones. To understand the seismic nature of replacing her with a solid conservative, look at *Casey*: Justice O'Connor cast the decisive fifth vote to overrule Mr Alito's verdict, co-authoring the opinion that argued that “a state may not give to a man the kind of dominion over his wife that parents exercise over their children”.

Some cerebral conservatives, such as Princeton's Robert George, justify the coming battle on pedagogic grounds: the country needs a proper debate about the role of the Supreme Court. Conservatives should eschew the stealth strategy not just because it often fails (stealth conservative judges have a way of morphing into stealth liberal ones), but because it misses an opportunity to shape public opinion. They want to use the next few months—for that is probably what it is going to take to confirm Mr Alito—to conduct a prolonged debate about the constitution. Is it a living document or a founding text? Should judges be chosen on the basis of what they believe about abortion and affirmative action or on the basis of their legal reasoning? Should courts take an expansive view of their constitutional role?

This all sounds very high minded. But there is a rather more elemental reason why many other conservatives are spoiling for a blood-drenched fight. They want revenge for what happened to Robert Bork in 1987, when the distinguished conservative jurist was subjected to a campaign of vilification. They want to get revenge for a series of judicial decisions that have turned judges from umpires into (liberal) philosopher kings. And many of them just want to be able to unleash the huge conservative legal propaganda machine that they have spent the past 20 years assembling for just such a fight.

Liberal America also wants a battle. Liberals are equally keen on defending their view of the Supreme Court as the ultimate guardian of civil and reproductive rights. And they are equally keen on testing their war machine in battle. No sooner had Mr Bush nominated Mr Alito than People for the American Way vowed to mobilise 750,000 activists to wage a “massive national effort”. The left already has its story-line in place: Mr Bush capitulated to the “far right” by jettisoning Ms Miers and nominating a machinegun-loving male supremacist who will overturn *Roe v Wade*, the ruling that protects abortion choice.

Go nuclear early

Yet conservatives have the edge when it comes to intensity. The reason for this is simple: conservatives think that they have a good chance of winning the Alito battle. The battle will not be easy, but the right has two things on its side.

First, Mr Alito looks a strong candidate. He has such glittering legal credentials that he earned unanimous confirmation to the Third Circuit back in 1990 from a Democrat-controlled Senate. He also has a judicial temperament. He hasn't engaged, as Mr Bork did, in a headlong attack on the Supreme Court's liberal-leaning jurisprudence. Yes, he has earned the nickname Scalito because he shares some views with the court's leading conservative, Antonin Scalia, but he is a less abrasive figure—more in the mould of Mr Roberts than his fellow Italian-American. And despite being yet another Catholic, making a potential five on the court, Mr Alito seems to believe in restricting rather than overturning *Roe v Wade*: he struck down a New Jersey law banning partial-birth abortion because it did not include an exemption for cases where the mother's life is at risk.

Second, the Republicans are in a commanding position in the Senate. In May, the “Gang of 14” (seven senators from each party) cooked up a deal to avoid Republicans using the “nuclear option” (ie, getting rid of the filibuster technique that Democrats can use to delay appointments). Under the deal, the seven Democrats cannot block Mr Alito's nomination unless they can demonstrate “exceptional circumstances”. That seems unlikely. If they break the deal, then the

Republicans can press the nuclear button. In retrospect, skinning cats was for wimps; real conservatives are thinking about Armageddon.

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Apology: The Taurus Group

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From The Economist print edition

In our article last week on the Volcker report on the UN oil-for-food scandal ("Naming names") we mistakenly identified a company cited in the report as being the Taurus Group of New Zealand. In fact, the Taurus Group listed in the report is "an oil trading consortium based in Europe and the Caribbean". The Taurus Group in New Zealand and its subsidiaries have had nothing to do with Iraq. Our apologies to all concerned (this error has been corrected online).

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The Summit of the Americas

Uncle Sam visits his restive neighbours

Nov 3rd 2005 | BUENOS AIRES AND SÃO PAULO
From The Economist print edition

Reuters

Latin America's relations with the United States are not as good as they were, but not as bad as Venezuela's Hugo Chávez would like

THE heads of government of the 34 countries in the Americas that claim to be democracies will gather on November 4th and 5th in Mar del Plata, an Argentine resort. Two among them will dominate proceedings: George Bush and Venezuela's Hugo Chávez. That is not because they are the wisest leaders present or because they are the richest, although the United States' economy dwarfs all others in the region and Mr Chávez commands windfall oil wealth. Mr Bush and Mr Chávez, who are expected to avoid each other in Mar del Plata, will steal the limelight mainly because they represent opposite poles of a strident hemispheric debate.

At the first Summit of the Americas, in Miami in 1994, all the region's governments signed up to a common vision of democracy and free trade. That consensus was starting to fray by the third summit, in Quebec in 2001; now at Mar del Plata, the fourth, it has unravelled. The gathering's worthy official theme is to promote employment. But how? The plan for a Free Trade Area of the Americas (FTAA), originally due to come into effect this year, has stalled, as Mr Bush admitted this week. He said that the Doha round of world trade talks should take precedence. In any event, Brazil is reluctant to endorse a new timetable for the FTAA.

Mr Chávez, whose commitment to democracy is ambiguous, is peddling a “Bolivarian Alternative for the Americas”, named for South America's independence hero. It consists mainly of offers of cheap oil and a rhetorical declaration against poverty. So far it has been endorsed only by Cuba's Fidel Castro who, as a dictator, is excluded from the summit. But Mr Chávez's populist nationalism

has an appeal in some Andean countries, where democracies are shaky and societies are riven by inequality. He plans to express his opposition to Mr Bush at an “alternative summit” outside the police cordon in Mar del Plata.

Latin America is in an anti-*yanqui* mood, if slightly less so than a couple of years ago. The Iraq war was unpopular in the region, and there is disillusion with free-market reforms that are seen as having been sponsored by the United States. Peter Hakim of Inter-American Dialogue, a think-tank in Washington, DC, says that relations between the United States and Latin America have reached their lowest point since the cold war.

Recently, the superpower has been paying more attention to its neighbours. So far this year both Condoleezza Rice, the secretary of state, and her deputy, Robert Zoellick, have visited the region, and Donald Rumsfeld, the defence secretary, has done so twice. Roger Noriega, widely seen as a Cuba-obsessed ideologue, was replaced as the State Department's top man for Latin America by Thomas Shannon, a career diplomat. In the view of Mr Hakim, Mr Shannon has a “much better sense of what's important to the region”. There is even a glimmer of civility between the United States and Cuba. Mr Castro has accepted an American offer to send three aid officials to assess hurricane damage.

These gestures do not seem to have much substance behind them, however. In July, the United States Congress narrowly ratified a free-trade agreement with Central America and the Dominican Republic. But talks on a similar accord with Colombia and Peru are moving slowly.

Mr Chávez may feel he is winning friends faster. One of them, Evo Morales, a leader of the indigenous coca growers, could win Bolivia's presidential election next month, and Mr Chávez is trying to buy influence elsewhere. This year Venezuela has bought $950m of bonds from cash-strapped Argentina. It has also talked of buying an Argentine nuclear-power plant and Ecuadorean bonds.

Mr Chávez hopes to form a “new axis” with Argentina and Brazil. Venezuela wants to become a full member of Mercosur, the trade group those countries lead, in December. That would be a coup for Mr Chávez but a setback for Mercosur, which already has difficulty sticking to its rules.

Yet even though many governments are happy to take Venezuela's cash, it is easy to exaggerate the country's influence. While flirting with Mr Chávez, Argentina seems determined to run a well-behaved summit that ends with some semblance of consensus. Néstor Kirchner, Argentina's president, who would like an IMF agreement next year, has been careful not to pick fights with Mr Bush.

To strengthen such moderation, Mr Bush plans to stop in Brazil on his way home from the summit. He and Brazil's president, Luiz Inácio Lula da Silva, are not soul mates. Mr da Silva denounces the invasion of Iraq, yearns for a “new geography” that would dilute American power and has resisted the FTAA. Bilateral relations are merely “correct”, in the description of Rubens Barbosa, a former Brazilian ambassador to the United States. Yet the Americans regard Brazil, South America's biggest country by far, as a swing vote in a shaky region and have consistently praised its orthodox economic policies. Lula “occupies a unique position in the hemisphere,” said Mr Bush.

And so the “working visit” is likely to be an amicable one. The United States has recently signalled new flexibility on issues important to Brazil, such as an offer to make substantial cuts in tariffs on farm trade. It is grateful that Brazil has led a UN peacekeeping mission in Haiti, though it is not clear whether this will prove successful. A “strategic dialogue” is “developing gradually”, says a senior Brazilian diplomat. Irritants, such as a dispute over American cotton subsidies, are being kept under control.

The United States hopes that Brazil will help in reining in Mr Chávez and stabilising neighbouring democracies. Brazilian diplomats stress that Lula has close ties to Bolivia's Mr Morales. Venezuela's membership of Mercosur would come with a commitment to maintaining democracy. But the best antidote to *chavismo* would be progress against poverty and inequality. That will take time.

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Canada

Martin, the inquiry and the ghosts

Nov 3rd 2005 | OTTAWA
From The Economist print edition

The prime minister is exonerated, but a sleaze scandal may have lasting effects

Get article background

APPROPRIATELY enough, it was on Halloween that Paul Martin was handed his advanced copy of the Gomery Report into political sleaze. Mr Martin's first action on taking office as Canada's prime minister in December 2003 had been to cancel a controversial programme to promote federalism in Quebec which had turned into a slush fund for his Liberal Party. To try to lay its ghost, Mr Martin appointed John Gomery, a federal judge, to investigate. As expected, his report absolves Mr Martin of any blame, heaping it instead on his predecessor, Jean Chrétien, and senior officials. Opposition threats to bring Mr Martin's minority government down over the issue look hollow. But the “sponsorship scheme”, as it is known, may have done lasting damage to Canada.

Mr Chrétien set up the scheme in 1996 after voters in the French-speaking province of Quebec had only narrowly rejected secession in a referendum. The idea was to promote Canadian unity at sporting and cultural events. Mr Gomery's brief was to look into how the scheme was abused for political ends, and in particular at C$147m ($100m) paid in fees and commissions to a dozen advertising and public-relations firms, most of which found its way into the coffers of the Quebec Liberal Party.

Mr Gomery was blunt. He found “clear evidence of political involvement” in the scheme, “insufficient oversight”, “gross overcharging” and a “culture of entitlement” to cash and other benefits among those administering it. He pinned much of the blame on Mr Chrétien for “omissions” in setting up the scheme through his personal office, and on Jean Pelletier, his chief of staff, and Alfonso Gagliano, his public works minister, for its mismanagement. An advertising man has already pleaded guilty to fraud; a senior civil servant, Chuck Guité, the man who awarded the sponsorship contracts, faces charges.

Mr Martin, who was finance minister throughout the scheme's duration, is explicitly exonerated. He welcomed the report, told the police to act on it, ordered the Quebec Liberal Party to repay the C$1.1m Mr Gomery found that it had received in kickbacks, and banned from the party ten individuals, including Mr Gagliano.

The prime minister can reasonably claim to have acted decisively when confronted with evidence of wrongdoing. Even so, the sleaze scandal has haunted him—and may continue to do so. It helped to rob him of the personal mandate he sought when calling an election in 2004 which reduced the Liberals to a parliamentary minority. Last spring, the opposition came within one vote of toppling the government on a confidence motion.

Predictably, Stephen Harper, the Conservative leader, and Giles Duceppe, of the separatist Bloc Québécois, used the report to attack the prime minister. Jack Layton of the New Democrats, a

leftish party which supports the government, accused Mr Martin of continuing the “culture of entitlement”. There has been talk of the opposition trying again to force an early vote. Yet Mr Martin seems likely to escape. Elections in the Canadian winter are disliked by voters. Mr Martin has anyway promised to call one within 30 days of Mr Gomery's final report—on how to avoid such abuses in future—which is due by February 1st. By then, sleaze may have faded in the public mind.

But the poison from the sponsorship scheme leaves the Liberals debilitated. The Gomery report has revived the rivalry between Mr Martin and Mr Chrétien, a wily political fighter. Mr Chrétien stole the headlines this week with his mischievous wit at a press conference. He accused Mr Gomery of bias in choosing to believe the testimony of Mr Guité, and said he would seek judicial review of the report.

The lasting damage from this sorry affair is to Liberal support in Quebec. Liberal sleaze has helped to resuscitate the Bloc, and its provincial sister, the Parti Québécois. Because the Liberals will probably win few seats in the province, the next election—even if held in the spring—is likely to return another minority Liberal government. The separatists are well-placed to return to power in the province. It would be ironic indeed if the result of the sponsorship scheme turned out to be the break-up of Canada.

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Cuba

Perilous crossing

Nov 3rd 2005 | HAVANA
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New ways of leaving

THE economy has finally pulled out of the penury inflicted by the end of the Soviet Union and its subsidies. Fidel Castro, Cuba's Communist president, has promised better transport and housing and a swift end to power cuts. Recent hurricane damage might make those promises hard to fulfil even for the most efficient government. But some Cubans are not waiting around to see. Once again, a rising number of Mr Castro's people are risking their lives to escape from his island.

In the 12 months to September 30th, the United States Coast Guard intercepted 2,712 Cubans, compared with 1,225 during the same period in 2004. More than 2,530 made it to the Florida shore, compared with 954 the previous year. According to an American diplomat, 6,000 crossed the Mexican border in the year to September, where because of their increased numbers separate holding facilities were recently built for them.

Some migrants make headlines. A young man converted a 1951 Chevrolet pickup truck into a vessel but was stopped by a Cuban patrol. A six-year-old boy drowned in October after a suspected smuggler's boat capsized while trying to elude the Coast Guard. But most remain anonymous. The lucky ones make it into the United States. The unlucky are caught at sea or in third countries and repatriated, or lost to the ocean depths.

A 1994 agreement between the two governments allows 20,000 Cubans to move legally to the United States each year. Since then, American policy has been to grant legal entry to those who manage to set foot on its territory, but to send back those caught at sea. As a result, taking to rafts for the perilous journey across the Florida Straits has become less common. Instead, Florida-based smuggling gangs have sprung up: they charge $8,000-15,000 per head to bring Cubans by fast boat or by obtaining false Mexican papers. Half the cash is usually paid in advance by relatives in the United States, and half upon arrival.

The most expensive, and safest, route involves buying a Mexican visa and Cuban exit permit, and a flight or boat to Mexico. Unlike Mexicans, Cubans are not sent back when they cross the northern border. Cheaper is a ride in an overloaded speedboat across the straits, braving Cuban and American patrols. The poor must fashion their own rudimentary transport, or pay up to 10,000 pesos (about $430) for a ride in someone else's.

When tragedy strikes, both countries blame each other. When a speedboat sank in August, killing 31, Mr Castro said that the American trade embargo, the privileged status the United States awards Cuban migrants and Florida smugglers were at fault. American officials said the dead were fleeing totalitarianism, economic bungling and oppression. They accused Mr Castro of doing little to stop emigration.

In one way, the United States may indeed have encouraged the exodus. Last year it cracked down

on travel to the island by Cuban-Americans, who may now visit Cuba only once every three years, and only to see members of their immediate family. For his part, Mr Castro taxes remittances from Cuban-Americans, sticks to his failed economics and refuses to allow his people to come and go freely.

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Guatemala

Swept away

Nov 3rd 2005 | PANAJACHEL AND SAN MARCOS
From The Economist print edition

Rebuilding after Hurricane Stan

Get article background

AFP

After the flood, the pain

AS THE waters rose around his house in the small town of Panajachel, Cristian Rodríguez carried as many of his belongings as he could to a neighbour's. By the next day, both houses had been destroyed. They now lie beneath a river of rocks 40 metres wide. Boulders—some the size of small cars—were carried down from the mountains overlooking Panajachel, a popular tourist spot on the shores of Lake Atitlán in Guatemala's highlands. Only memory can identify where the houses once stood.

Other natural disasters, some bigger, have attracted more attention in recent months. But for Guatemala, a poor and weak democracy, the floods and mudslides triggered by Hurricane Stan in early October were a body blow. Almost 1,500 people were killed. Some 40,000 people remain in temporary shelters; another 100,000 are staying with friends or family. Most have lost their livelihoods. In some areas, up to 80% of crops were lost, while perhaps 100,000 farm animals were killed. Roads and water systems were ravaged. A third of Guatemala's population of 13m were affected by the disaster one way or another.

According to Andrés Botrán, the minister for food security, the government and aid agencies will have to feed tens of thousands of people for a year, until the next harvest, in a country where one person in two was already malnourished. The government is building shelters for the refugees. The challenge is to avoid such temporary solutions from becoming permanent problems.

Some lessons have been learned from past disasters. After Hurricane Mitch in 1998, high-risk areas were identified. Efficient evacuation procedures in such places meant that only one person died in his town, says Marco Antonio Orozco, the mayor of San Marcos, in the north-west. But others were not so lucky: in San Marcos and Panajachel and in other more remote areas, mudslides struck unexpectedly, cutting swathes through villages.

There are a few reasons for hope. The cities were largely unaffected, and most main roads have been quickly repaired. Most of Panajachel's hotels are open again, even if tourists are scarce. Guatemala has long been misgoverned, but aid specialists are full of praise for the government of Oscar Berger. After an initial delay when nobody realised the extent of the disaster, the government's response was quick and efficient. The government has re-routed existing loans from the World Bank and Inter-American Development Bank to reconstruction. Officials say they will avoid rebuilding in the riskiest areas.

In Panajachel, Mr Rodríguez vows not to rebuild where his house had been. He hopes the site can be made into a park. But he says he does not know where he will live. Land is scarce, money scarcer and aid insufficient, he complains. Mr Berger's challenge is to ensure that the promise of reconstruction becomes a reality.

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India and Pakistan

Stalling tactics

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From The Economist print edition

AP

Terrorist bombs in Delhi have strained India's peace process with Pakistan

Get article background

NOT long ago, it would have led to immediate talk of war. The co-ordinated terrorist attack on Delhi on October 29th, in which three bombs exploded within 30 minutes of each other, killed more than 60 people. Many were shoppers, stocking up for Diwali, the biggest Hindu festival of the year, on November 1st, and the Muslim festival of Eid, two days later. Police and officials were quick to voice suspicions of Pakistan's involvement. Yet, within hours, India and Pakistan had announced one of the biggest steps yet towards easing tension in their long dispute over Kashmir.

In response to the earthquake that struck both the Indian and Pakistani parts of the territory at the beginning of October, they announced a limited opening of the “line of control” that divides it, to allow relief workers and separated families to cross. Far from thwarting agreement, the atrocity in Delhi nudged Pakistan, in particular, into making the concessions needed to reach it. Yet the peace process is nevertheless damaged. On October 31st, Pakistan's president, Pervez Musharraf, called again for the “demilitarisation” of Kashmir. India, smarting from the terrorist attack, and exasperated at General Musharraf's habit of negotiating through press conferences, studiously ignored him.

Delhi has a history of terrorist attacks. After the latest, the police detained more than 20 people. They saw the hand of Lashkar-e-Taiba, a Pakistan-based group fighting Indian rule in Kashmir. In theory it is banned in Pakistan, but remains active. A less well-known Kashmiri group—thought to be dormant or defunct—calling itself Islamic Inqalabi Mehez (“Islamic Revolutionary Front”)

claimed responsibility. Indian analysts dismissed this as Lashkar covering its tracks.

In December 2001 an attack on the Indian Parliament, also blamed on Pakistan-backed militants, did bring the two nuclear-armed neighbours to the brink of war. Since then, however, relations have been transformed. Although a two-and-a-half-year-old peace process has not made much progress on the Kashmir dispute, a series of confidence-building measures has made war almost inconceivable.

Peace is proving popular in both countries. But the insurgency in Indian Kashmir drags on, with more than 1,500 people killed so far this year. The killings have continued even since the earthquake. Seven people died in a suicide car-bombing in the outskirts of Srinagar, capital of Indian Kashmir, on November 2nd, the day a new chief minister of the Indian state of Jammu & Kashmir took office in the city. The bomber was said to be a resident of Pakistani-controlled Kashmir.

The previous day, America had complained that one of its helicopters, carrying earthquake-relief supplies in Pakistan-controlled Kashmir, came under rocket fire—presumably from the militant groups. Pakistan insisted the helicopter had encountered nothing more sinister than a blast of dynamite clearing a landslide-blocked road.

Peace is proving popular in both countries. But the insurgency in Indian Kashmir drags on

The hugely destructive natural disaster, in which at least 74,000 people have died, has made human conflict seem petty. As the harsh Himalayan winter looms, a desperate humanitarian crisis is unfolding, putting pressure on both governments to “soften” the line of control. The meeting that agreed the breakthrough on this, in Islamabad, may have provided one motive for the terrorist attacks in Delhi. Militants may be anxious to disrupt a peace process which they have good reason to fear is likely to end in a perpetuation of the status quo in Kashmir. Similarly, in April this year, on the eve of the opening of a fortnightly bus-service across the line of control, militants staged a vicious attack on the passengers in Srinagar.

The militants may also want to disprove reports that the earthquake, having destroyed some of their training camps in Pakistani Kashmir, has severely dented their strength. Or perhaps they wanted to mark the sentencing, on October 31st, of militants found guilty of an earlier attack in Delhi, in 2000. Of the seven convicted, the mastermind of that attack, a Pakistani, was sentenced to death.

If the terrorists' aim was to derail the peace process, they have failed in the short term, and Pakistan itself was swift to condemn the outrage. In the long run, however, India's prime minister, Manmohan Singh, may find it harder to make much progress. On October 31st, he told General Musharraf by telephone that India had “indications” of the bombers' “external linkages”. Already, the main opposition, the Bharatiya Janata Party, has blamed the bomb blasts on the government's “going soft” on terrorism.

Both opposition and government will concentrate on General Musharraf's failure to crack down definitively on the Pakistan-based militant groups. General Musharraf has banned the most notorious of them. But their members have simply regrouped under other names. To the horror of some liberals in Pakistan as well as Indian and other observers, the “new” groups have played a prominent role in relief work after the earthquake, sometimes with the logistical support of the Pakistan army.

Indian hawks have long believed that parts of the Pakistani army and intelligence services have an interest in prolonging the conflict in Kashmir. That is why, they say, General Musharraf proves so unwilling—or unable—to put the militants out of business altogether. So the atrocity in Delhi is

bound to have an impact on India's willingness to pursue the peace process. It may even dent one of its central pillars: the personal trust between Mr Singh and General Musharraf.

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Japan

Koizumi's last shuffle

Nov 3rd 2005 | TOKYO
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The prime minister plans to ensure his reforms outlast him

Koizumi's new cabinet

Selected members

Junichiro Koizumi	Prime minister	Age 63	Unshuffled. Due to retire in September 2006
Shinzo Abe	Chief cabinet secretary	51	Foreign-policy hawk, popular with female voters. Domestic reform credentials are unproven
Taro Aso	Foreign	65	Like Abe, grandson of a former PM. Even more provocative than Abe about Japan's imperialist past
Fukushiro Nukaga	Defence	61	Chief job will be reshaping US-Japanese alliance
Heizo Takenaka	Internal affairs and postal reform	54	Architect of most prominent Koizumi reforms; now has his work cut out tackling civil service
Sadakazu Tanigaki	Finance	60	Surprisingly long-serving finance minister, in charge of Japan's most entrenched bureaucrats
Kaoru Yosano	Economics and financial affairs	67	Party veteran, has held several cabinet posts in past governments. Now brought into the heart of structural reform
Kuniko Inoguchi	Equal opportunities	53	Foreign-policy academic with multilateralist instincts. Out of step with more hawkish colleagues

Source: *The Economist*

Get article background

JUNICHIRO KOIZUMI says he wants to have time to dine out and listen to music again. So though he led the Liberal Democratic Party (LDP) to a landslide victory in a snap general election in September, he still insists that he will step down as prime minister next September, after five years in the job, when his term as LDP president expires. Since he has also promised to give those in the running to succeed him the chance to prove themselves before he goes, the cabinet reshuffle that took place this week—presumably his last—has been eagerly dissected.

The only man in politics approaching Mr Koizumi in popular appeal is Shinzo Abe, whom the prime minister has now brought into the cabinet as chief cabinet secretary. This 51-year-old is considered, at least by political standards, to be both youthful and good-looking. He is from a notable political dynasty. And, perhaps contributing most to his popularity, he has taken a hard line against North Korea over their abduction of Japanese people in the 1970s and 1980s. What has probably counted most with Mr Koizumi, however, is that Mr Abe has been a staunch supporter of his domestic reforms. This week came his reward. The chief cabinet secretary has power second only to the prime minister, for not only is he responsible for managing the cabinet, but he also serves as the government spokesman.

When asked whether he was interested in the top job, his rival, Taro Aso, replied with un-Japanese frankness: “I should say so.” His prospects will not have been harmed by being made foreign minister, a reward for helping Mr Koizumi, as internal-affairs minister, with the drive to privatise the post office. A third possible contender for the leadership is Sadakazu Tanigaki, who may have been relieved to keep his job as finance minister: Mr Koizumi is said to have berated him last week for not pushing reform hard enough.

The fourth politician until recently thought of as a candidate, Yasuo Fukuda, failed to make it back into the cabinet after resigning as chief cabinet secretary last year. At 69, his age may have counted against him, and he was probably no fan of Mr Koizumi's centralising style of leadership. He has also long taken a foreign-policy line notably softer towards China than that of either Mr Abe or Mr Aso. These two not only advocate a more muscular role for Japan in international and security affairs, in large part in order to counter a rising China, but also visit the Yasukuni shrine, a symbol of Japan's militarist past.

The prime minister, then, has promoted potential successors in the same nationalist mould as himself. But it is in the realm of domestic policy that they will have to prove themselves, for the reshuffle, more than anything, shows Mr Koizumi's determination to push on with reform. Mr Tanigaki's chief job, for example, is now to privatise or get rid of eight government-affiliated banks; he will also have the unpopular task of pushing through a rise in the sales tax to help cut the budget deficit.

The new minister for the economy and financial affairs, Kaoru Yosano, who comes from running the LDP's policy-research council, takes over the post that has been at the heart of Mr Koizumi's reform drive. The previous incumbent, Heizo Takenaka, an academic economist whom Mr Koizumi brought into government to sort out first the banks and then the postal system, has been made minister for internal affairs. He will also continue to oversee postal reform. His main task will be to slash the numbers of civil servants and to decentralise government powers to tax and spend. But if he rises to the challenge, Mr Takenaka might even be considered as being a potential interim prime minister. After all, no one now doubts Mr Koizumi's capacity to surprise.

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China

Here's Hu

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Enigmatic, but ubiquitous

PRESIDENT HU JINTAO, who only a few years ago had hardly set foot outside China, has become quite a globetrotter. His flurry of trips abroad this year most recently included his first state visit to North Korea, where Mr Hu has been capitalising on global concerns about the country's nuclear ambitions to establish China as a broker of peace. Known for his conservatism at home, could Mr Hu the diplomat be a bit more adventurous?

North Korea's leader, Kim Jong Il, at least gave Mr Hu face by pledging to continue its involvement in the six-country talks, hosted by China, aimed at resolving the crisis surrounding its nuclear weapons. The North Koreans said they would uphold a vague agreement reached at the last round of talks in September, which committed the country to abandoning its nuclear-weapons projects, rejoining the Nuclear Non-Proliferation Treaty and submitting to the safeguards of the International Atomic Energy Agency. The next round is due to start on November 9th.

Mr Hu's diplomacy has been sweetened by handouts. He and Mr Kim toured a recently completed $30m glass factory close to Pyongyang, donated by the Chinese. Mr Hu also attended the signing of an agreement on economic and technical co-operation. Details have yet to be announced, but it suggests that China remains committed to propping up its neighbour's tattered economy.

Such a high-profile visit implies that China is reasonably confident that the talks are not about to

collapse. A breakdown would be a setback for Mr Hu, who—unusually given China's normal preference for back-seat diplomacy—has decided his country should play an active role in trying to resolve the crisis.

Mr Hu is doubtless hoping to bask in the glory of his Korea diplomacy later this month when he sets off on his next trip (after North Korea, he spent three days in Vietnam boosting ties with another somewhat wary neighbour). This will take him to Britain, Germany and Spain, and then to South Korea for the first state visit there by a Chinese president in a decade. In South Korea Mr Hu will attend a summit of Asia-Pacific leaders, including President Bush, who will then proceed to Beijing for what will be his first visit to China since Mr Hu assumed office in March 2003.

Since becoming president then, Mr Hu has travelled far and wide, often in the pursuit of strategic partnerships with commodity-rich potential suppliers for China's industrial machine. To that end he has toured Latin America, Africa, Australia, Canada and Central Asia. There remain, however, some notable omissions from his itinerary. He has yet to visit Japan, a country where he has shown little inclination for bold initiatives aimed at resolving festering disputes. He would have paid his first state visit to America only in September—and, as it happened, the main part of the trip was delayed by Hurricane Katrina, though he did make it to the United Nations in New York. Even if the trip had gone ahead, it would not have been entirely to the satisfaction of Mr Hu, a stickler for ceremony. His aides had been pressing for a more lavish welcome than Mr Bush was prepared to give.

All this exposure, however, is not adding much to the sum of knowledge about Mr Hu himself. He is the first top Chinese leader whose date of birth is a secret—December 1942 is all one is told. Diplomats say he is very bright, but apprehensive about informality. That may be a mercy: his predecessor, Jiang Zemin, was famous for impromptu after-dinner sing-songs.

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South Korea

Once a snoop, always a snoop?

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The past returns to haunt South Korea's secret services

Get article background

OLD habits die hard. When South Korea was a military dictatorship, its secret policemen thought nothing of bugging political dissenters. This was supposed to have stopped once the country became a democracy in 1988. Apparently it didn't.

South Koreans were astonished to discover this year that even under democratic governments the spies in their National Intelligence Service (NIS) continued to listen in to the conversations of leading personalities. The scandal came to light after the discovery of a wire-tap recording, made without judicial approval, of a conversation between South Korea's ambassador to the United States and a top executive from the Samsung Group. They were allegedly discussing plans to make illegal campaign contributions to candidates in South Korea's 1997 presidential election. The tapes provoked a furore and prompted the ambassador's resignation.

Since then, prosecutors have raided the NIS's headquarters; its chief has admitted that unauthorised eavesdropping was commonplace; a former deputy chief has been charged; and investigators are still quizzing agency chiefs who served during the administration of the former president, Kim Dae-jung.

The scandal is a particular embarrassment to Mr Kim, a winner of the Nobel peace prize who, as an opposition democracy campaigner, was himself a target of surveillance and almost killed by what was known at that time as the Agency for National Security Planning. Once in office, Mr Kim pledged to clean the agency up. He changed its name, reshuffled its personnel and vowed that it would no longer be involved in domestic political surveillance.

Mr Kim's supporters are adamant that neither he nor his top officials ever approved any of the later wire-taps. Sceptics say that this is inconceivable. At the least, it seems that Mr Kim failed to impose the control he had promised. The NIS now says that illegal bugging ended with the wholesale destruction of all bugging equipment before the current president, Roh Moo-Hyun, came to office in 2003. But the row continues. Meanwhile, investigators say they have uncovered more than 270 illegal recordings. Lots more to listen to.

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Cambodia

You can't say that here

Nov 3rd 2005 | PNOMH PENH
From The Economist print edition

Free speech is vanishing

Reuters

Hun Sen the strongman

HUN SEN, Cambodia's prime minister of the past 20 years, is not the sort to follow outsiders' advice slavishly. The donors who fund half the country's budget are constantly wringing their hands about his unfulfilled pledges of reform. But the prime minister has picked up at least one foreign habit of late: suing opposition politicians and democracy activists for libel—a political tactic pioneered in Singapore and recently adopted in Thailand.

Mr Hun Sen, his Cambodian People's Party, and his royalist allies FUNCINPEC are all suing Sam Rainsy, the leader of the only opposition party in the National Assembly, for accusing them of corruption and other misdeeds. Another member of parliament for the Sam Rainsy Party (its real name) is charged with libelling Prince Norodom Ranariddh, the leader of FUNCINPEC. The head of the prime minister's bodyguard has sued two more of the party's MPs, including Mr Sam Rainsy's wife, for defamation. A fifth MP is already in jail, convicted of fomenting a rebellion. Mr Sam Rainsy fled the country in February, as his parliamentary immunity was removed.

The campaign against criticism is now spreading beyond the National Assembly. In October Mr Hun Sen accused the owner of the only independent radio station, the heads of three unions and a critical member of the royal family of misrepresenting a border treaty he recently signed with Vietnam. “I have been patient for too long,” said the prime minister, explaining his sudden litigious streak.

Admittedly, Cambodian politicians and pundits are prone to intemperate declarations laced with wild allegations. But the prime minister himself is the chief offender: in the same speech, he accused various royals of betraying the nation, implied that the army chief was insubordinate and announced to anyone contemplating a coup, “You do it, you die.”

Several of the current cases look quite flimsy, yet the treatment of the suspects has been harsh. The radio-station owner, for example, is being sued not for anything he himself said, but for allegations made by someone he interviewed. Yet he is being held without bail, and charged not under the civil code or the press law, but under the tougher criminal code. Samoura Tiulong, Mr Sam Rainsy's wife, did nothing more objectionable than translate into English a witness's account of an assassination attempt on her husband.

Opposition politicians argue that the courts are biased in the government's favour. For no

apparent reason, a military rather than a civilian court heard the case against Cheam Channy, the MP accused of rebellion, with predictable results. Meanwhile, the opposition's various lawsuits against different officials have been brusquely dismissed. Local NGOs, western diplomats and the United Nations' point man on human rights in Cambodia agree that there is little hope of a fair trial in any of the libel suits.

No wonder, then, that several of the accused have fled the country. Mr Sam Rainsy is refusing to return until his parliamentary immunity is restored. In fact, after the most recent round of arrests, several NGO leaders who were not facing any lawsuits also took flight, just in case. That must suit the government fine: its most persistent critics have gone to ground.

Observers argue that the crackdown follows a pattern. During elections, when Cambodia is briefly under international scrutiny, the prime minister allows his critics to speak their mind. Between polls, he undermines civil liberties, prevents his opponents from organising, and makes an example of a few of the most outspoken. Still, things could be worse. Some people bleakly claim to see a shred of progress in the lawsuit fad: at least mysterious assailants seem to have stopped murdering the government's critics.

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Afghanistan

Southward, ho!

Nov 3rd 2005
From The Economist print edition

NATO plans a date with the Taliban

Get article background

ON OCTOBER 29th, a British soldier in northern Mazar-i-Sharif became the first combat fatality of the NATO-led peacekeeping mission in Afghanistan this year. In the same period, 59 American troops serving with an American-led coalition force have been killed by Taliban insurgents in the south and east of the country—as well as more than 1,000 Afghans in fighting there. The contrast between the NATO-led lot and the American-led lot is striking. Whereas the latter force is 17,000-strong and engaged in counter-insurgency, NATO's International Security Assistance Force (ISAF) of around 9,000 troops timidly patrols Kabul and a few towns of the north and west, where there is no insurgency. But this will soon change. NATO is headed for the perilous south.

The advance will be co-ordinated by the alliance's expeditionary command headquarters, the British-run Allied Rapid Reaction Corps (ARRC), which is due in Kabul next April, for a nine-month stay running ISAF. Part of its job will be to take over three small coalition garrisons dedicated to reconstruction—known as Provincial Reconstruction Teams (PRTs)—in three southern provinces: 200 Canadians are already in Kandahar, a similar number of British will go to Helmand, and a combination of Dutch and Australians to Uruzgan.

The PRT model was designed by America as a low-cost way to please Afghans. It has been adopted by ISAF in northern and western Afghanistan, where it has the double advantage of requiring few troops and satisfying European governments that their fighters are unlikely to get killed. In western Herat, for example, ISAF has 150 Italian soldiers. Asked to describe their security provisions, an Italian officer said he had issued the local police with bicycles.

In southern Afghanistan, home to the xenophobic Pushtuns, stiffer provisions are needed. Each

PRT there will be protected by a battlegroup of around 1,000 NATO soldiers, also reporting to the ARRC. The British PRT in Lashkargar, for example, will be supported by a beefed-up British battalion, probably of the Royal Anglian regiment, that also will train Afghan troops. In addition, the ARRC will command a mobile reserve of 1,000 British troops, mostly paratroops, based in Kandahar. They will be supported by an American aviation battalion, of the coalition, and 12 NATO Apache attack helicopters, six Dutch and six British.

In typical NATO fashion, more effort has been spent on reaching a consensus to send ISAF south—with, for example, timorous Germany reluctant to leave the north—than on working out what it will do when it gets there. Under real threat of attack in the south, ISAF troops will require less restrictive rules of engagement, though they are unlikely to seek fights in the way the Americans do. And though Britain is leading the effort against opium production in Afghanistan, and talks of giving its troops a counter-narcotics mission in the south, it is unclear what this might be, and whether European governments would let their troops fulfil it.

In theory, ISAF's advance south should lead to a merging of the two forces in Afghanistan. But with most European NATO members still unwilling actually to fight, America will keep charge of the rough stuff, even if its troops are melded into ISAF. Whether the merger happens next year, as America wants, may depend on how many NATO troops in the south the Taliban manage to kill in the interim.

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Uzbekistan

Waiting for the other shoe to drop

Nov 3rd 2005 | ANDIJAN AND TASHKENT
From The Economist print edition

Slaughtering unarmed demonstrators and turning his back on America has not made President Islam Karimov safer

RTR - AFP

Karimov and his handiwork

Get article background

ANDIJAN'S prison, rammed at high speed on May 13th by a hijacked truck to free prisoners, now has new gates and zig-zag concrete blocks outside. The town hall, where government hostages were held by protesters, is being reconstructed. Buildings facing Babur Square, where up to a thousand peaceful bystanders were gunned down by government troops as they listened to protesters' speeches, are still pockmarked by mortar and bullet holes. But five months after the atrocity—probably the worst committed by a government against demonstrators since Tiananmen in 1989—there are few other overt signs of the uprising against the repressive, and economically disastrous, regime of Islam Karimov. Yet its fallout continues.

The irony is that while these events shocked the world and prompted the EU, after much hesitation, to impose sanctions, few Uzbeks know what really happened. This is due to the blocking of all communications during the May events, a continuing government propaganda effort, and show trials, the first of which (of 15 alleged ringleaders) has just ended with guilty verdicts. Their aim was to exonerate the regime, and in this they succeeded. One woman, now in fear of her life, testified to the killing, but all the accused pleaded guilty to being terrorists with foreign connections and of having done the shooting themselves. The government has also tried hard to create the spectre of foreign-linked religious extremists intent on taking over the country, rather than just desperate Uzbeks who wanted a better life.

But while their knowledge is mostly hazy, many Uzbeks say “everything” has got worse since Andijan. Surveillance and security have been ratcheted up still further. There are police every 50 metres in Tashkent and dozens of roadblocks on the single mountainous road that leads to the Fergana valley, where Andijan is located. New methods of control include civilian informers who report directly to the police. Indigenous neighbourhood committees now keep tabs on the population. Most foreign NGOs have been closed down, the remaining few threatened. The BBC closed its Tashkent office last week, after much harassment: its one foreign reporter was withdrawn in June.

Besides Andijan, the trigger for a widening crackdown has been President Karimov's growing anxieties following other popular revolutions in the region—starting with Georgia, then Ukraine and finally Kirgizstan, on Uzbekistan's own border. For all of these, he has explicitly blamed the “intrusive meddling” of America and the West. Shortly after the Kirgiz revolution, in March, many of the roads to government buildings in the centre of Tashkent were blocked off. Hedges of flowering shrubs to which inhabitants were much attached were cut down, presumably to stop potential terrorists using them as cover.

Anti-western propaganda has become ever more strident in the state-controlled media, and the western press is routinely accused of fomenting a “fifth column”. Words have given way to deeds and the Americans—ordered in July to leave their military base by the end of the year—are busy packing up. Meanwhile, the economic situation in Uzbekistan grows steadily worse. The country has enormous gold reserves, is one of the world's largest cotton producers, and has uranium and sizeable oil and gas deposits. But virtually no wealth trickles down to people beyond an elite circle of a few thousand. Cotton pickers earn a pittance, while farmers are forced not only to grow crops selected by the government but then to sell their entire crop at low state prices. Smuggling is widespread; there is scarcely any industry to provide jobs or create wealth.

Some of the worst poverty in the country is found in the densely populated Fergana valley, home to 8m people, a third of the country's population. The valley is politically volatile and has a history of religious fervour. Locals in Andijan and the valley say that the revolt in May was not an isolated incident, but one of many that had been taking place throughout the country. Although the tree-lined streets of Andijan now appear calm, the mood is tense, angry and fearful. Efforts to undercut the social unrest, including releasing long-overdue pensions, wages and salaries, have been undermined by a subsequent wave of arrests of anyone believed to be connected to or have knowledge of the uprising. There have been beatings and forced confessions.

Despite the grim outlook, many Uzbeks think the chances of change are slim. Some say they fear a bloodbath. Others say that 67-year-old President Karimov is politically stronger than ever. He is financially self-sufficient, and protected by the region's largest and best equipped army and security forces, which are estimated to employ one in three of the population.

Even so, others believe that another popular uprising like the one in Andijan could happen. None of its underlying causes have been addressed. “It could take another harsh winter and all heat and power failing as it did recently, for the people to rebel,” says one observer, adding that security forces might well refuse to turn on the people again. One well-informed source said that within the elite tough questions are urgently being asked about the wisdom of the new anti-western course being pursued—and about the efficacy of the president's policies. Unrest lies just beneath the surface, kept down only through extraordinary repression.

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Iran

Is the new president truly an exterminator?

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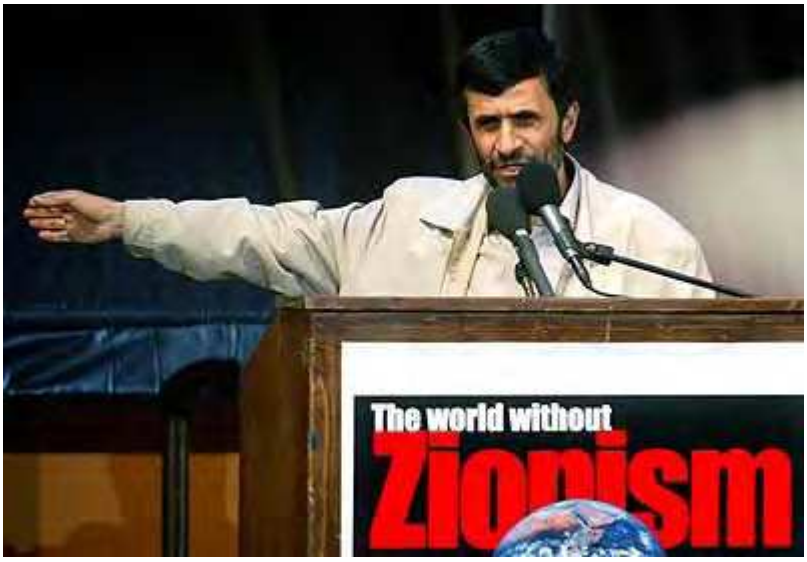
From The Economist print edition

Reuters



Mahmoud Ahmadinejad's diatribe against Israel and the United States was made against a backlog of muddle, infighting and weakness

Get article background

“YOU can't sow the wind and not reap a hurricane.” Thus Saeed Leylaz, an Iranian economist, the day after Tehran's stockmarket plunged to its lowest level for two years in response to worldwide condemnation of a venomously anti-Israel (and anti-American) speech by Iran's president, Mahmoud Ahmadinejad, on October 26th. Mr Leylaz bleakly notes a discrepancy between “running a country” and “pursuing transformative ideals”.

His message may be lost on Mr Ahmadinejad. The president's description of Israel's “occupying regime” as a “disgraceful blot” that should be “wiped off the map” recalled a time, after the revolution of 1979, when Iran's leaders competed to sound outrageous. The inexperienced and unworldly Mr Ahmadinejad probably had no idea that his comments would provoke such revulsion—or lead Tony Blair, Britain's prime minister, to muse that he might have to “do something” about Iran. After all, the president explained, he was only quoting Iran's revolutionary leader, the late Ayatollah Ruhollah Khomeini.

Mr Ahmadinejad's reiteration of that bit of orthodoxy was a gift to those nations, led by America, Britain, France and Germany, that want the governing board of the International Atomic Energy Agency (IAEA), the UN's nuclear guardian, to refer Iran's nuclear activities to the UN Security Council with a view to imposing punitive sanctions. Discussion of the programme, which Iran

insists, to American and European scepticism, is purely peaceful, is sure to dominate the IAEA's next meeting later this month.

In Tehran, embarrassed commentators suggested that Mr Ahmadinejad had spoken figuratively; his target was not Israel, but the “Zionist mindset”. A government spokesman asserted that Iran “has never used force against a second country”. But a pattern, baleful for Iranian diplomacy, is starting to emerge. An earlier aggressive speech by the president, to the UN General Assembly in September, also backfired, shoring up support for a tough anti-Iran resolution at the IAEA's last meeting.

For the conservative establishment that helped Mr Ahmadinejad to power in last June's election, the president's comments underline the dangers of promoting untested ideologues. Publicly bound to Khomeini's radical legacy, Iran's ruling clerics have quietly abandoned important parts of it. For instance, they have shelved the death-penalty *fatwa* that Khomeini served on Salman Rushdie for writing an allegedly blasphemous novel, and they have cultivated ties with Saudi Arabia, whose kingdom Khomeini detested. In public, they now regret the West's wilful “misinterpretation” of their president's comments; in private, they rue the new man's habit of saying what he thinks.

Iran's opposition to Israel and support for the Palestinians, while enshrined in the constitution, has always been less straightforward than the rhetoric suggests. In the 1980s, when Iran's Revolutionary Guards were helping Syria to set up the Hizbullah movement in Lebanon, Iran's government was secretly using Israel as a conduit to buy American arms for use in the war against Saddam Hussein's Iraq. More recently, during the presidency of Mr Ahmadinejad's reform-minded predecessor, Muhammad Khatami, Palestine policy became a domestic issue. Though he was deliberately vague, it is thought that Mr Khatami did not share his conservative opponents' abhorrence of a two-state solution. He too has rubbished Mr Ahmadinejad's recent remarks.

But sometimes, plainly, Iran has tried to help Palestinian rejectionists in their war against Israel. Conservative ideologues are said to have been the senders of a cache of Iranian arms, bound by ship for Palestine, which the Israelis intercepted in 2002. The incident helped persuade President Bush to include Iran in his “axis of evil” in the same year, ending Mr Khatami's efforts at détente with the Americans, which did not displease Iran's conservatives.

In public, they now regret the West's wilful “misinterpretation” of their president's comments; in private, they rue the new man's habit of saying what he thinks

Iran lionises Palestinian suicide bombers and goes through the motions of preparing its own, though no Iranian “volunteer” is known to have carried out a mission. Iran also still backs Lebanese Hizbullah, which, having helped oust Israeli forces from southern Lebanon in 2001, nowadays portrays itself as a mainstream political party, albeit still dedicated to the elimination of Israel as a Jewish state. Iran may still help finance such violent Palestinian groups as Islamic Jihad and Hamas. And various prominent Iranians, not just the new president, have praised the idea of Israel's destruction. Rockets at parades have been inscribed with calls for Israel to be eradicated from the annals of history. Israelis are disinclined to assume that such threats are merely rhetorical.

Ayatollah Ali Khamenei, Khomeini's successor as Iran's supreme leader, trumpets the influence that Iran, despite being Shia and non-Arab, supposedly enjoys in the Sunni-dominated Arab world. But few Arabs joined Iran in observing Jerusalem Day, Khomeini's “worldwide” day of solidarity with the Palestinians, which fell this year on October 21st. As for Mr Ahmadinejad's remarks, Arab countries greeted them with stony silence, while the Palestinian Authority condemned them.

Just bluster, then?

Given Iran's cocktail of fierce rhetoric, double-dealing, ambiguity and pragmatism, it is questionable how much of a threat it truly poses to Israel. For sure, Israel was bound to react with horror to Mr Ahmadinejad's bellicosity; across the political spectrum, Israelis regard Iran's nuclear programme, secretly developed over the past 19 years, as an existential threat. But the CIA reckons that Iran is unlikely to achieve a bomb-making capacity for five to ten years. Iran's main threat now comes through proxies in Hizbullah and among the Palestinians. Israel would certainly react fiercely to any direct attack.

Moreover, it is arguable that Iran's leaders, by seeking to achieve a nuclear capacity for purposes that are (to say the least) ambiguous, are keener to secure their own regime's survival in the face of American hostility than they are to destroy the Israeli state. Indeed, despite Mr Ahmadinejad's diatribe, they know that any serious attempt to attack Israel would be more likely to provoke a large-scale assault, perhaps terminal, on the Islamic republic.

Plainly, Mr Ahmadinejad's remarks have done Iran little good. It is easier, now, for America to paint Iran as a menace that needs confronting. Yet far from showing any sign of backing down, he seems set to overturn Mr Khatami's more conciliatory foreign policy. He has recalled several top Khatami-era ambassadors to Tehran. He vilifies Muslim countries that recognise Israel, and favours imposing economic penalties on countries that backed America and the Europeans at the IAEA.

In any event, other challenges loom. Syria, a longtime friend, is under pressure for its apparent role in the killing of Rafik Hariri, a former Lebanese prime minister, earlier this year. And Sunni-run Arab countries, especially Saudi Arabia and Jordan, condemn what they say is Iran's effort to turn Iraq into a chauvinistic Shia state.

By talking tough, Iran's president has actually weakened his country in the world

Yet Iran's attitude to Iraq is ambiguous too. The Iranians want Iraq's emerging Shia-dominated democracy to survive but probably do not want it to thrive, lest Iraq then feels strong enough to let the Americans set their sights on Iran. The Americans and British in Iraq suspect Iran of giving money and arms to Iraqi Shia groups who have attacked the occupying forces. But the Iranians have tricky relations with Muqtada al-Sadr, the most belligerent of Iraq's Shia leaders, and shrink from picking a sectarian fight with Sunni fanatics. At least 150 Iranian pilgrims have died in attacks on Iraqi Shias by Sunni rebels in the past few months, but Iran has been careful not to respond with anti-Sunni invective.

So, despite Mr Ahmadinejad's noises, Iran knows it is vulnerable. In the past five months, at least 13 people in Iran's part-Arab city of Ahwaz, quite near Iraq's border, have died in bomb attacks. Iranian officials blame, variously, Baath party remnants, Arab separatists and the British.

The effect of Mr Ahmadinejad's diatribe, and the muddled foreign policy that underpins it, is already being felt. Confidence in the sector that Mr Leylaz works in, carmaking, has been shaken by rumours that Iranian customs officials are holding up South Korean auto-parts to punish the Koreans for backing the Americans at the IAEA. Capital has flown, making the Tehran stockmarket's loss Dubai's gain. Like other Iranian technocrats, Mr Leylaz rues his inability to “plan ahead”. So do many other Iranians. All in all, by talking tough, Iran's president has actually weakened his country in the world.

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Palestine and Israel

Wrong guy to kill

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Israel's latest (mis)targeted killing could play into the Islamist hands of Hamas

EPA

Masking his intentions, for now

IT WAS a mistake that was bound to happen eventually. This week an Israeli missile hit a car in the Gaza strip that was carrying Hassan al-Madhoun of the al-Aqsa Martyrs' Brigades, the militants affiliated to the Fatah party that runs the Palestinian Authority. Mr Madhoun, Israel said, had been responsible for a series of recent attacks. What it did not realise was that with him in the car was Fawzi Abu al-Karei, a top man in the Izz ad-Din al-Qassam Brigades, the militant wing of Hamas—the Islamist party that is Fatah's main opposition.

The Israeli army quickly detailed Abu al-Karei's previous and planned crimes too, as if to justify his death. But it will now watch nervously for the response. Though the *tahadia* (calm) declared by Palestinian militant groups in March and the suspension of "targeted assassinations" by the Israeli army have both been breached many times, the most notable breaches have involved Palestinian Islamic Jihad (PIJ), a small group that, unlike both the al-Aqsa and the Qassam brigades, has no corresponding political wing and little popular support.

PIJ is thought to receive much of its money and orders from abroad, possibly (perhaps indirectly) from Iran. While Hamas and Fatah have an interest in keeping some peace in the run-up to a parliamentary election in January, the PIJ, though claiming to uphold the ceasefire too, may be trying to destabilise things for the sake of it or to win support from the minority of Palestinians who favour a return to the *intifada* (uprising). It was responsible for a suicide bombing last week that killed five Israelis, and for three others this year. In the last few days Israel has lashed out with a series of arrests and killings of PIJ militants.

Israel has always said it will continue to hit both those who have just carried out attacks (hence its assassination of Mr Madhoun) and those it thinks are about to. The militants, and especially the PIJ, have often responded in kind. But Hamas has been unusually restrained recently, though Israel claims it has covertly sponsored some attacks by other militant groups. Israel, in return, has tried to avoid killing Qassam brigade men, though it recently arrested hundreds of Hamas activists.

As Abu al-Karei's death showed, however, intelligence information is not perfect. By killing him without a direct provocation, Israel has played into Hamas's hands. At worst, the violence could escalate. But a Hamas spokesman said that the group would still keep to the *tahadia*. If so, that will only increase popular sympathy for it, and give another little boost to its election prospects.

Zanzibar

Spiced with tear-gas

Nov 3rd 2005 | ZANZIBAR
From The Economist print edition

An election in Zanzibar, Tanzania's main island, is violently disputed

EPA

Voting the wrong way

WITH Tanzania's mainland elections postponed until December 18th following the death of a vice-presidential candidate, only the semi-autonomous island of Zanzibar went ahead with its vote as planned on October 30th. Polling day was peaceful enough. But the announcement two days later that the ruling Party of the Revolution (better known by its Swahili initials, CCM) had yet again swept the board in presidential and parliamentary elections was greeted by riots and the reported deaths of five opposition people at the hands of the security forces, as the outcome was fiercely rejected by the opposition Civic United Front (CUF).

Official results returned the incumbent president, the CCM's Amani Karume, son of Zanzibar's first president, with 53% of the vote. The CUF's Seif Sharif Hamad had 46%. The CCM also won 30 of the 50 seats in Zanzibar's parliament. Earlier, the CUF had declared itself a narrow winner in the presidential race and a solid winner in the parliamentary one. The CCM, it said, had rigged the voting register and falsified results at polling stations.

It is an article of faith among CUF supporters that the Zanzibar elections in 1995 and 2000 were also stolen by the CCM. Probably they were. And despite a larger presence of international observers, the CCM was at it again this time round. Less educated CUF supporters were bullied or simply turned away. Some militiamen voted several times. The CCM allegedly bought votes (for about $110, said some recipients) and spent liberally on posters, rallies, and free T-shirts, whereas CUF supporters paid for their own gear. One CCM tactic, witnessed by *The Economist* in a village called Fujoni, was to have registered boys as voters months ago, then whisk them through the polling stations to vote CCM when observers were not looking.

Just how many dodgy votes the CCM grabbed is impossible to say. Why it did so, with Tanzania's economy and reputation on the up, is easier to understand: it rules Zanzibar as it does mainland Tanzania as a one-party state. The rhetoric and faded black-and-white photos in the CCM's island headquarters still hark back to the revolutionary struggle for independence. Yet that brand of austere African socialism promoted by the late Julius Nyerere, independent Tanzania's founding father, never caught on in Muslim Zanzibar, with its historic ties of trade and kinship to Arabia.

But the CCM's apparatchiks remain. The party controls government appointments on the islands and favours its supporters in the regulated export of cloves, a spice used in making toothpaste and chewing gum. The CCM has improved the provision of water, electricity and rural roads. Tourism is quite well handled and is heading up-market. Even so, Zanzibar is much poorer than it should be. Not enough is made of its spice industry (pepper, cinnamon and vanilla, as well as

cloves). Fishing is still unmodernised.

Western diplomats tended to deride the vote in private but endorse it publicly, arguing that it is more important to keep mainland Tanzania stable, with its 36m people, than to fret over the threat of more violence in Zanzibar and its nearby fellow island of Pemba, with their 1m people. Besides, if the CCM is monolithic and heavy-handed, the CUF is an odd coalition of Zanzibar's present underclass and its former Arab-oriented overlords. It has convinced most observers that it is not an Islamist party, but there are doubts whether it could propel Zanzibar forward if it gained power; some of its lieutenants have made cavalier economic promises.

Will the CUF now be able to control its own? Despite its laudable appeals for non-violent protests, “Zanzibar Liberation Front” slogans have been provocatively daubed on the exquisitely distressed alleys of Zanzibar Town's Stonetown district—and may be seen by CUF hotheads as a call to armed struggle. Some people fear that, without more economic development and a lighter governing hand than CCM politicians are used to, it might come to that.

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Famine relief

The wonders of Plumpy'nut

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Saving lives with peanut butter

THE brand name may be whimsical, but Plumpy'nut, a peanut paste made in France, is doing more than make hungry kids giggle; it is helping them stay alive. A mix of minerals, vitamins and powdered milk, the paste may transform famine relief. Starving infants, sucking it out of foil packets, can gain weight at the impressive rate of up to a kilo (2.2lb) a week on nothing but a 1,000-calorie daily diet of Plumpy'nut. A four-to-six-weeks' course of it to restore a child's health costs about $20, a tenth of what the usual treatment for malnutrition costs in an average African hospital, says the UN's World Food Programme.

Better still, Plumpy'nut is transforming the way children in famine areas are looked after, says Dr Steve Collins, director of a London-based aid agency, Valid International. Mothers can administer the paste in their own homes, rather than rely on doctors in feeding centres and clinics. When starving children are looked after in distant hospitals, mothers often camp outside, unable to tend their crops and healthier children back home. The famine-stricken usually rely on hospitals ill-equipped to handle large numbers and often rife with disease.

Developed in 1998, Plumpy'nut was first used on a large scale in Sudan's embattled Darfur region in 2003. In Niger, where some 3m people are still short of food, Médecins sans Frontières (MSF), an aid agency, now uses Plumpy'nut in large quantities, letting it send four-fifths of severely malnourished children home from hospitals and therapeutic feeding centres, so freeing up beds. “We've never been able to treat so many people,” says Milton Tectonidis, an MSF nutritionist in Niger. “The swing to outpatient treatment is remarkable,” says Emily Mates, a nutritionist with another agency, Concern Worldwide, in Ethiopia. “Most NGOs have gone down the outpatient route and we consider those that haven't rather backward.”

Plumpy'nut has the consistency of mashed potatoes, so infants, often toothless or too weak to chew, can suck it right out of the squishy packet. Since peanuts are a staple in much of Africa, the taste is both familiar and strong enough to mask the yucky flavour of the added vitamins and minerals: zinc is especially bitter. Lucky kids.

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German politics

Building problems

Nov 3rd 2005 | BERLIN
From The Economist print edition

Angela Merkel's attempts to construct a grand coalition have run into trouble

Get article background

HAVING difficulty comprehending Germany's political shenanigans? Consider Dresden's Frauenkirche, formally reconsecrated last weekend. Rebuilding this landmark Baroque church, which Allied bombers turned into rubble in 1945, has been a task of enormous complexity, spanning more than a decade. Although it may not take quite that long, putting together a "grand coalition" to run Germany after the election on September 18th is proving a similarly monumental task.

For days after the election, Chancellor Gerhard Schröder refused to admit defeat, even though his Social Democrats (SPD) had won fewer seats than Angela Merkel's Christian Democrats (CDU) and her Bavarian sister party, the Christian Social Union (CSU). Yet he eventually yielded, a new cabinet drawn from both sides was agreed, a coalition deal was under construction—and the scene seemed set for Ms Merkel to be elected Germany's new chancellor on November 22nd.

But this week, two of the grand coalition's main architects resigned—at least partially. On October 31st Franz Müntefering, chairman of the SPD, announced that he would step down, after his party's executive committee had rejected his candidate for the SPD's number two position. A day later, Edmund Stoiber, leader of the CSU, declared that he would prefer to remain as Bavaria's

premier, rather than joining Ms Merkel's government as economics minister. Yet both say they intend to continue leading their negotiation teams for the coalition—and Mr Müntefering still seems to want to be Ms Merkel's vice-chancellor and labour minister. The question now is whether the entire edifice of the grand coalition may collapse, meaning that the country could head for fresh elections, probably next March.

Even to insiders, this latest turn of events has come as a surprise. Germany had settled into a negotiation routine. The coalition-building machine seemed to be running relatively smoothly. Once or twice a week, the main delegations would meet to talk about the big picture. In between, 17 working groups would get together to hammer out more detailed proposals. In total, nearly 200 politicians have been directly involved.

Predictably, there were many leaks, which helped to fill the papers and create a sense of increasing controversy. But the emerging coalition's inner circle—which, besides Ms Merkel, Mr Stoiber and Mr Müntefering, includes Mr Schröder, Peer Steinbrück, the designated SPD finance minister, and Roland Koch, the CDU premier of Hesse—seemed to have developed a measure of trust and good working relations. Last week, the team planned to reduce the budget deficit. This week they agreed on a corporate-tax cut.

Yet just as the Frauenkirche needs strong pillars to support its dome, a grand coalition needs disciplined parties to support the government. In other words, the SPD cannot be both in government and in opposition. That is why Mr Müntefering insisted on installing his right-hand man, Kajo Wasserhövel, as the party's general secretary, rather than leaving this job to Andrea Nahles, unofficial leader of the party's left wing, who thinks that the SPD should be re-establishing its credentials as a people's party to improve its appeal and fend off the Left Party.

Although Mr Wasserhövel had been expected to win, on October 31st the party's executive committee voted 23 to 14 for Ms Nahles. Some certainly share her reasoning and rightly consider her a talented politician. Others were fed up with Mr Müntefering's increasingly autocratic leadership style. Yet others may simply not have realised that there would be such serious consequences. At all events, shortly after the vote, Mr Müntefering declared that he would not stand for re-election as party chairman at the SPD's next congress in mid-November.

Mr Müntefering's abrupt decision almost spun the party out of control. Most members of the executive board were in a visible state of shock: one resigned, and more are expected to follow. Only with the quick nomination of Matthias Platzeck, premier of Brandenburg, as candidate for SPD chairman, did a semblance of calm return. Even the CDU welcomed the choice of an eastern German premier who heads a grand coalition in his own state. He is popular without being populist and is widely touted as a prospective SPD chancellor of the future.

In the meantime, Mr Stoiber had announced his decision to stay in Bavaria—officially because he thinks that the SPD is no longer a reliable partner without Mr Müntefering, with whom he gets on well. But most see this as an excuse. Mr Stoiber has been in a huff ever since he failed to get the “super ministry” he wanted; after a series of petty power games he is no longer taken very seriously; and a battle over the succession in Bavaria threatens to split the CSU. After the dust settled, Michael Glos, head of the CSU's parliamentary group, emerged as its new pick to become economics minister.

Even if the turbulence passes, this week's events have made the birth of a grand coalition more difficult. The SPD's left wing has shown itself much less willing to accept compromises in order to stay in government. It is now a lot less likely that a grand coalition will attempt to go beyond mere repair work—such as reducing the budget deficit and reforming federalism—and tackle more far-reaching reforms. Optimists, however, argue that the in-fighting has reduced the SPD's chances at any new election, so it may yet prove readier to agree to a deal with Ms Merkel.

The pressure of time doesn't help. Next week will be crucial. The parties have set November 12th as an unofficial deadline for an agreement—just in time for the SPD's congress, which must endorse the grand coalition. But there is also pressure on Ms Merkel to reach a deal: she has scheduled a party conference on December 5th to discuss why the CDU did so much worse than expected on September 18th. If she has still not been elected chancellor by then, critics and rivals within the party might switch from support to attack. Many fault her personally for the disappointing result.

In more than one way, indeed, the CDU and the CSU see themselves as facing the same strategic challenge as the SPD: do they want to remain big-tent people's parties, or will they push for necessary but painful economic reforms that might strip away some of their backing? Ms Merkel, in both her person and her programme, stands for the second approach, but many in the party prefer the first. If the negotiations on a grand coalition fail and Germany heads for a new election, it is not even clear that she would again be the opposition candidate for chancellor.

If this week's events reveal anything, it is that Germany's mainstream parties are in their worst crisis since the war. Even though it will be painful, their best chance for a lasting comeback may be to form a grand coalition and make it work. Otherwise, even more voters will opt for the competition to their left and right.

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Italy and Iraq

Election bloops

Nov 3rd 2005 | ROME
From The Economist print edition

Silvio Berlusconi tries to please two audiences at once

Get article background

THANKS to pre-recorded television, politicians can now have the out-of-body experience of being in two places simultaneously. Italy's prime minister, Silvio Berlusconi, was this week not just in two places at once—he also managed to say contradictory things.

Standing with President George Bush in the White House, he spoke proudly of being "side by side with our American ally in broadening the borders of democracy and freedom", standard neo-conservative language justifying the invasion of Iraq. But back in Italy, he was simultaneously telling an interviewer that he had "never been convinced war was the best way to make a country democratic", precisely the argument against the war used two years ago by France and Germany.

Mr Berlusconi said that he had tried "many times" to dissuade Mr Bush and had even enlisted the good offices of Libya's leader, Muammar Qaddafi, to act as a mediator. These claims stupefied the opposition, which has always seen Mr Berlusconi as a poodle of Washington's. Mr Berlusconi's supporters were able nevertheless to point to a trail of comments that he had made hinting at reservations over the invasion. Perhaps he set aside such misgivings for the sake of retaining influence with the Americans. But if that were the case, why would he reveal his doubts now in such a high-profile way, just as he left for Washington (extracts from the television interview were released in advance)?

The cynical answer is that Mr Berlusconi faces an election next April and knows that his support for America's foreign policy is unpopular. But that may not be the whole story.

Until his latest swerve, Italy was in the same position as Spain before its election in March 2004, with an opposition committed to withdrawing troops from Iraq. That situation may have led to al-Qaeda's bombings of Madrid's trains on March 11th 2004, killing 191 people and perhaps helping to swing the election in favour of the Socialists. By shifting his position now, Mr Berlusconi has gone some way to mitigating the risk of such an attack, which could blow his chances of re-election. It remains to be seen whether he might go even further by withdrawing Italy's contingent in Iraq, the third-largest after America's and Britain's.

There is another possible explanation for Mr Berlusconi's behaviour: that he is trying to avoid the backwash from the Plame affair in America. The bogus documents purporting to show that Iraq was trying to buy yellow-cake uranium were allegedly forged in Italy. Claims have been made that the Italian intelligence services forwarded them to the Americans and the British, knowing them to be misleading. The theory is that Italy's spymasters wanted to ingratiate themselves with Mr Berlusconi who, in turn, wanted to ingratiate himself with Mr Bush. But Mr Berlusconi can now argue that, since he never wanted a war, there was no reason for him to forward intelligence—still

less bogus intelligence—aimed at justifying one.

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Parisian riots

Car-burning in the suburbs

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Reuters

A week of riots in Parisian suburbs followed an incident on October 27th, when two North African teenagers were electrocuted in Clichy-sous-Bois, apparently while fleeing the police. As unrest spread, the government held emergency talks to discuss “sensitive urban zones”. With 10% unemployment and a poor Muslim population largely confined to grim suburban housing estates, the ingredients for social explosion have long been brewing. In fact, vehicle-burning has become the suburban crime of choice. Last New Year's Eve some 333 cars were burned, a figure the police celebrated as “stable”.

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Italian television

Ho, ho, very satirical

Nov 3rd 2005 | ROME
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A new show that says much about media freedom in Italy

THE new talking-point for Italians is a television programme. “RockPolitik” is a three-hour extravaganza alternating music with comment and satire. By the standards of other western European countries, it is pretty tame. But in a country whose leader directly or indirectly influences all six main television channels, it is revolutionary.

Mr Berlusconi's Mediaset group owns Italy's three biggest private stations. Parliament chooses the board of the state-owned RAI, which runs the other three leading national channels. Until “RockPolitik”, satire had virtually disappeared from Italian screens. Yet 11.5m Italians tuned in for the programme's opening night. All the shows have secured pages of press coverage as journalists pick over every audaciously irreverent word.

The programme is hosted by a rock star-turned-showman, Adriano Celentano, as famed in Italy as he is unknown outside. He managed to extract from RAI's bosses a guarantee not to interfere with the content of his series. In his first programme, he highlighted a survey of press freedom that ranked Italy a lowly 77th. Then he welcomed a journalist not seen on screen since Mr Berlusconi criticised him three years ago. In the second show, Mr Celentano allowed an Oscar-winning comic, Roberto Benigni, to hurl jibes at the prime minister.

Mr Celentano is no left-winger. In his monologues, he has damned gay marriages and praised Pope Benedict XVI. This has not stopped Mr Berlusconi from deploring “RockPolitik” as proof that the media “systematically attacked the work of the government”. The second-biggest party in his governing coalition called for the resignation of RAI's director-general. The government had already put off plans to privatise the broadcaster, on the ground that its finances are so rocky.

Some suspect Mr Berlusconi of wanting to exploit the excesses of “RockPolitik” as an excuse to change the law on political advertising to let him spend more money in next April's election. But any such plan may backfire. As *La Repubblica*, a centre-left newspaper, commented, “RockPolitik” has given back to Italians “the sense of a free country”.

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The Balkans

Approaching Europe

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The countries of the western Balkans get nearer to Brussels

Get article background

WHEN French and Dutch voters rejected the European Union constitution, the shockwaves were swiftly felt in the Balkans. In 2003 EU leaders had promised the region eventual membership. Was that promise now going to be broken? Surprisingly, several events in the past month suggest that it will be kept. Many years, and many pitfalls, lie ahead. But, despite resistance in some quarters, EU policymakers seem to have decided that it is better to have these countries inside the club, rather than causing trouble outside.

A look at the map explains why. In 2007 Romania and Bulgaria are due to join the EU, although that date may slip to 2008. The remaining Balkan countries will then be encircled by the EU. Unless they have a genuine prospect of membership, that could have serious consequences. With some 22m people penned inside a kind of poor Balkan reservation, inter-ethnic conflict, smuggling and organised crime would be certain to flourish. Compared with the cost of all that, EU membership might look quite cheap.

Following this logic, Croatia won the go-ahead for formal membership talks last month. A week later, Serbia and Montenegro began preliminary talks that should lead to eventual membership. On October 21st Bosnia was told that it too could begin preliminary talks. And next week the European Commission will give its opinion on Macedonia's application for membership.

It is no coincidence that these things are happening now. The decision on Croatia helped to win Austria round to the opening of talks with Turkey. Encouragement of Serbia was a way of counteracting the news that the United Nations secretary-general had been authorised to start talks on the future of Kosovo, whose population is over 90% ethnic Albanian. Kosovo looks set for some form of independence against Serbia's wishes; next year Montenegro may also hold a vote on independence. These events may be less unpalatable if Serbia sees EU membership ahead.

In Bosnia, Paddy Ashdown, the international pro-consul, says that a slew of much-needed reforms in the past two years were pushed through only because the country's leaders understood that they were the price of EU membership. A similar lure has worked in Macedonia. From the brink of all-out civil war in 2001, ethnic Albanians and Macedonians have worked together in government largely because of their common hopes of joining the EU. All sides are now praying that the commission will give a positive opinion and that, in December, EU leaders will award Macedonia its coveted candidate status. Yet most diplomats reckon that the Macedonians may get an amber not

a green light—that is to say, a yes to candidacy but with no promise of a date to begin talks. And some EU countries are still against even this.

The experience of new countries in the EU is that the conditions of membership have been sufficiently tightly drawn to help transform them into modern states. This is the path that Balkan political leaders want to follow. But, just when they want it most, money to ease the pain of reforms in areas that need it, such as agriculture, may turn out not to be there.

The problem is that only countries that are officially candidates for membership are due to receive significant amounts of aid. According to the European Stability Initiative, a Berlin-based think-tank, aid to Bulgaria should rise from €300m ($340m) in 2003 to some €1.6 billion by 2009; but aid to Serbia, with a similar population, will drop from €240m to €117m in the same period. This, argues the think-tank, is the sort of short-term thinking that will do nothing to prevent the region—and the EU as a whole—from storing up more Balkan problems later on.

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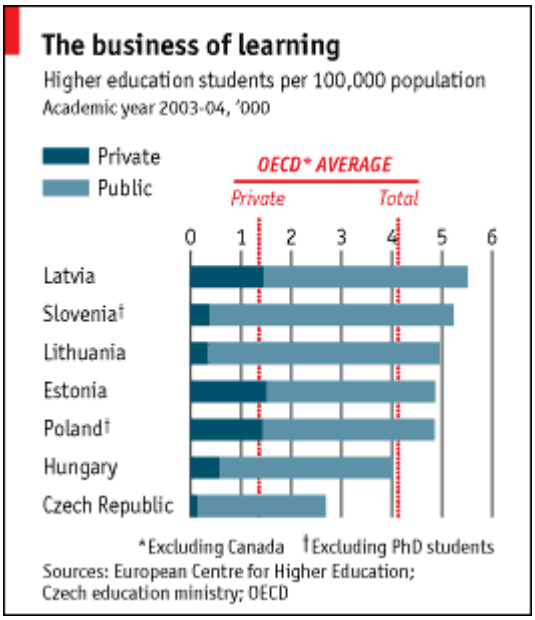
Central European universities

From Marx to marketing

Nov 3rd 2005
From The Economist print edition

Ex-communist countries are competing hard in the global education bazaar



IMAGINE an ambitious, globe-trotting youngster from Asia who wants a good, cheap degree from somewhere in Europe. At first glance, the continent's eastern half, with its communist heritage, lingering suspicion of non-Europeans, baffling languages and dreary tradition of rote-learning might seem an odd place to look. But in education, as in other industries, the new members of the European Union have the advantage of a past that leaves nowhere to go but up. Compared with their state-run counterparts in western Europe, where academics, bureaucrats and students unite against change, universities in countries once yoked to Moscow are adapting fast to a new global market.

At a Chinese education fair earlier this year, these colleges found keen interest in what they were offering: a European-level undergraduate degree with combined annual tuition and living costs of some €5,000 ($6,035). At a cheap western European outfit, such as Britain's Luton University, the cost would be three times more.

For now, the 23,000 non-EU students in the new EU members amount to a trickle. But if places that once taught Marxism can succeed in their makeover, it could turn into a torrent. Already, would-be doctors and vets from the “old EU” who fail to find places at home are heading for the Baltics or central Europe. Nor is the language problem insuperable. Many universities, including in such places as Cracow, Prague and Riga, offer courses entirely in English.

Some Asians like the idea of studying business in countries whose markets are still “emerging”. Private colleges such as Poland's LKAEM business school have grabbed that niche. Some state colleges are following suit, as in Hungary, where MBAs were pioneered in 1989 by George Soros's (private) Central European University.

Bursting lecture-rooms are not always good (think of Italy), but a recent surge in student numbers, local as well as foreign, in “new Europe” is one sign of rapid change. Places with liberal regimes have seen the fastest growth. In Poland, which deregulated universities in the 1990s, the number of students has risen from 500,000 to over 2m. Slovakia, with a more rigid system, has seen numbers double.

The region's nimbler, more market-oriented colleges have been helped by the new practice of

dividing education into chunks (bachelor's and master's degrees, for a start), with work sandwiched in between. An old-style five-year degree at a single campus would be costly, even at central European rates. Doing a short master's in Prague, say, is more manageable.

But modest fees and flexibility will not be enough to sustain the region as an educational magnet, says Roderick Floud, vice-president of the European University Association. He stresses the need for better quality control. Other observers advocate closer links between academia and business. As business and computer studies flourish, there are fears that not enough chemists or engineers are being trained to meet the needs of foreign investors.

An impending demographic dip is concentrating minds. Within a decade, there will be a drop of 40% in high-school numbers in Poland. Without more students from abroad, today's university boom could be short-lived. But Andrzej Kozminski, who runs Poland's LKAEM, insists that domestic demand can still grow, even in a country where almost half the youngsters between 19 and 24 get further education. He cites the expansion of distance learning and postgraduate work.

Yet ex-communist campuses can lose as well as win in global competition. As American and European professors of the baby-boom generation retire, colleges in rich countries will soon be recruiting hard. Without higher salaries, talented dons from new Europe could drift westwards.

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Moldova

Wobbling ahead

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The rogue republic of Transdniestria and its allies

DEPENDING on how you look at it, the self-proclaimed republic of Transdniestria is a mafia-run statelet that launders billions of dollars and sells weapons to terrorists and rogue states, or a refuge for Russian-speakers who would otherwise face persecution. The West wants the breakaway enclave, which is in theory part of Moldova, democratised and demilitarised. That would clean up business and help to stabilise one of Europe's poorest countries.

It would also mean sending home a rump force of Russian soldiers whose ostensible task is peacekeeping, following Transdniestria's armed getaway from Moldova in 1992. They guard a gigantic Soviet-era arms dump too, but their main job is to prop up the autocratic regime of Transdniestria's leader, Igor Smirnov. His other main prop is the state security ministry, run by formidable ex-KGB types closely linked to Russia.

Neither side can unfreeze this conflict. Russia has not quite managed to bully Moldova into accepting a confederation; and the West, only fitfully attentive, and handicapped by Moldova's erratic behaviour, cannot dislodge the regime in Transdniestria. Involvement by the Organisation for Security and Co-operation in Europe (OSCE) has been obstructed by Russia. Moldovan and other officials say they are disappointed by Ukrainian shilly-shallying, and complain that neither Britain, as current president of the European Union, nor America, will raise the issue with Russia.

Now new talks have started between the two sides, plus five outsiders: Russia, Ukraine, the OSCE, America and the EU. So far the results have been modest: an agreement to ask the OSCE to draw up plans for a mission to look at democratisation. One plan, privately endorsed by Russia and Ukraine with some EU backing, is to aim for simultaneous elections in both Moldova and Transdniestria late next year. In the meantime, Transdniestria is holding its own election on December 11th. The West will not send observers, saying that the poll is neither free nor fair. But it may be a chance to stoke up local opposition to Mr Smirnov.

The real problem is that Russia is pursuing two policies. The official foreign-ministry line is to go along with the talks. The other approach, run from the Kremlin, is to back Transdniestria and similar places as examples of “multiculturalism”—meaning that they provide special status for Russian-speaking or Russia-oriented minorities. Other bits of the former empire, such as the Baltic states and the Caucasus, think that has an ominous ring.

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Charlemagne

The farmers' friend

Nov 3rd 2005
From The Economist print edition

European agriculture is feeling beleaguered

Get article background

WHAT is it about Europeans and agriculture? Farmers account for only 2% of Europe's workforce. Yet in 1992, the president of the European Commission, Jacques Delors, almost scuppered the Uruguay round of world trade talks rather than cut farm spending. He accused his own negotiators of exceeding their mandate, and said “I'm not going to be an accomplice to the depopulation of the land.” Now it is happening again. President Jacques Chirac of France is accusing the trade commissioner, Peter Mandelson, of exceeding his mandate and says he may veto the Doha trade round rather than accept more changes to the common agricultural policy (CAP). The Irish prime minister chimes in that there has been quite enough CAP reform already.

There is more at stake here than self-interest. French farmers are, admittedly, the largest beneficiaries from the CAP. And French leaders seem peculiarly susceptible just now to infantile anti-market posturing. But the dispute about farming and world trade is about more than grandstanding or the protection of a special interest. In Europe, agriculture is not just any business. Agriculture is important everywhere, of course: that is why it is the most protected commercial activity in the world. But Europeans make a fetish of it. From the Eclogues of Virgil—a town dweller's paean to country life—to the Corn Laws in Britain, which this newspaper was founded in 1843 to battle against, to the Treaty of Rome, which singled out farmers for special help, agriculture has always been special in Europe. It is morally good, and support for it is a mark of civilisation.

This being Europe, one cannot leave things to the vagaries of individual taste, either; one must also rally the forces of the state. There must be bundles of cash (some 40% of the European Union budget goes on farming). There must be national or European standards for making bread, wine or cheese. One can even claim (as France did recently) that a yogurt-maker is a national champion. Yet there was always something odd about this. Why shouldn't coal miners get special treatment too? Why should governments fret about food security, and not supplies of medicines? For years, farming's “civilisational” appeal trumped such concerns. But recently, several things have eroded Europeans' distinctive attitudes to farming. The result is both a greater willingness to accept change and a prickly defensiveness on the part of those whose attitudes have changed the least.

The 1940s and 1950s were a time of food shortages in Europe. Understandably, the people who created what became the EU were concerned about rural poverty and food security. Now, a well-fed generation has grown up that is at least as concerned about poverty worldwide. Young people are more likely to believe that rich-country farm support imposes huge costs on the developing world (as it does). They are also more likely to agree that the CAP has not been successful in reducing rural poverty: 80% of farm support goes to the richest 20% of farmers.

Moreover, whatever justification may have existed for spending most of the European budget on agriculture in the 1960s, when the club had six members, it will not wash now that the EU has 25 members and a broader remit. The arrival of ten new countries from central Europe meant that the CAP had to be rethought. Without further change, it may be impossible to agree an EU budget for the next seven years. In 2000, EU leaders said they wanted to have the most competitive, knowledge-based economy in the world. Spending such a big chunk of the EU budget on a pre-industrial activity will not help to achieve that goal.

Such pressures persuaded Europeans to accept reforms which, by their standards at least, are fairly substantial. In 2003, the EU agreed to replace a blizzard of farm-support payments with a single payment scheme, which subsidises farmers' incomes directly, rather than by paying higher prices for their crops and livestock. This should remove the worst trade-distorting aspects of the CAP. Farmers now get paid an average of only one-third above world market prices, compared with 80% in the mid-1980s. Overall subsidies are down: from over two-fifths of farm receipts in the 1980s to one-third and falling in 2004.

The trouble is that the 2003 changes were a classic case of only partial reform, as everyone knew at the time. They were too little both for Europeans and for Europe's trading partners. They did not affect tariff levels, which are now the main subject of dispute between the EU and the rest of the world. Nor did the 2003 reforms do enough to resolve looming budget problems. Even so, they went too far for many farmers, who now see themselves as an endangered species.

A rural nostalgia

This defensiveness has been reinforced by the loss of influence of agriculture's best friend and beneficiary, France, after its people did the unthinkable and chose to vote against the EU constitution last May. Farming was once central to what the EU did, a Frenchman was director-general for agriculture as of right and France moulded the European Commission in its image. Now farming has gone from being an object of celebration to one of contention, and the French tend to think of the entire European Commission as an Anglo-Saxon plot. Clamouring about farmers satisfies the French government's desire to make a noise in the councils of Europe.

That does not necessarily mean that the French will carry out their threat to veto the Doha trade round. To do so would bring down on their heads not only the wrath of other countries—and of French consumers. It would also damage, perhaps irretrievably, one of the EU's central

institutional claims to global influence, that it negotiates on behalf of the world's largest trading block. But whatever happens to the Doha round, the arguments over the place of farming in the EU will continue—and with them, the questioning of Europeans' own sense of themselves as people with deep connections to the land.

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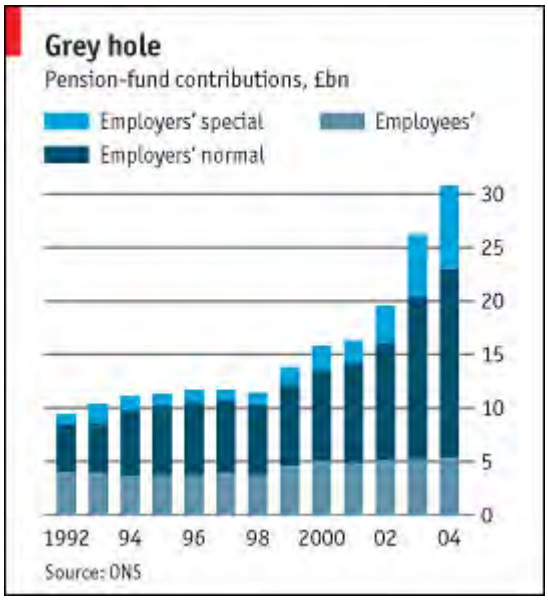
Funding pensions

Out of pocket

Nov 3rd 2005
From The Economist print edition

The true cost of Britain's corporate pension schemes



WHEN Gordon Brown, the chancellor of the exchequer, raised employer national-insurance contributions by £4 billion ($7 billion) a year in his 2002 budget, British business cried foul. But on October 31st, David Norgrove, chairman of the Pensions Regulator, set out proposals that will involve a cash call double that amount to get rid of company pension-fund shortfalls over the next ten years, and there was no great fuss. Instead, the stockmarket was galvanised by a takeover spree by foreign bidders for some big British firms.

A sanguine interpretation of this week's events is that prescient markets had already taken on board the scale of action needed to address pension-fund deficits. More likely, however, they have not woken up to the full impact of the regulator's proposals. That would be par for the course. There is a long, worrying history of government meddling in company pensions whose full impact is only appreciated years after the event.

The failure to grasp the impact of new measures arises from the complexity of arrangements for funding private defined-benefit (DB) pensions, which are linked to final salary and years of service. This has grown enormously in the past year, as a new insurance and regulatory framework for company pensions has been constructed. The groundwork was completed in April when the Pension Protection Fund (PPF) started and the Pensions Regulator became a force in the land, replacing OPRA, its feeble predecessor.

The PPF, supported by compulsory levies on company schemes, provides compensation for members of underfunded DB pension plans whose sponsoring employers go bust. From the outset, the government has sought to avoid the financial problems afflicting America's 30-year-old company pension-insurance system. At the latest count, the Pension Benefit Guaranty Corporation (PBGC) had a record deficit of $23 billion on its books, which many believe will require a government bail-out.

One distinctive feature of the British approach is that the PPF will rapidly make the levy mainly risk-based. Its charges will take into account both the funding of pension schemes and the risk that their companies may become insolvent. Another is that the regulator has been armed with powers to counter moral hazard—the temptation for companies to behave more riskily towards their pension funds once there is an insurance safety-net.

But these policies will prove ineffective as long as Britain's private DB plans remain perilously under-funded. The PPF does not provide full compensation: working-age members get 10% less in their prospective pension, which is also capped at a mere £25,000 a year; and indexation arrangements for pensions in payment are restricted. As a result, the benefits guaranteed by the PPF are worth some 30% less than the full value that would be secured through a buyout from an insurance company if a scheme had enough money, estimates Nigel Bodie of Watson Wyatt, an actuarial consultancy. Even so, the PPF revealed in July that the total deficit in company pensions under its valuation rules is £134 billion.

That estimate is broadly equivalent to the £130 billion deficit that companies are registering under the FRS17 accounting standard, according to new figures this week from the regulator. That gap has emerged in the past few years because falling stockmarkets, rising longevity and declining interest rates have together battered pension-scheme finances. The deficit has proved stubbornly difficult to shift, despite the recent recovery in stockmarkets.

On October 31st the regulator served notice, in effect, that companies must get rid of these deficits within ten years. It is saying that the trustees of schemes and sponsoring employers must now, in general, draw up recovery plans to eliminate their deficits by around 2015; otherwise it is likely to intervene. It argues that this is a reasonable timetable, since over a ten-year period the financial health of firms is more likely to deteriorate than to improve.

The regulator's plan is out for consultation, but its broad thrust is unlikely to change very much. Business regards the funding stipulations as onerous. In 2004 employers pumped £25 billion—equivalent to 2.2% of GDP—into pension funds, more than double the amount in 2001 (see chart on previous page). Around a third of this—almost £8 billion—was comprised of special contributions to reduce deficits. According to Mr Bodie, the regulator's proposals will require companies to stump up about a further £8 billion a year.

Estimates for the regulator by PWC, an accountancy firm, demonstrate the potential burden. These show that for 65% of companies, the cost of paying off their FRS17 shortfall would amount to less than 25% of their free cash flow (profits plus depreciation). But for 15% of firms, it would absorb 25-100%; and for 20% of companies, it would exceed the free cash that they can generate.

Furthermore, companies are also facing another financial strain, the payments they must make for pension insurance. Within a few weeks, the PPF will reveal the total bill that it will charge private DB schemes next year—the final building-block in the new structure for company pensions. The levy is likely to be double the government's original estimate of £300m a year, says Raj Mody of Hewitt, a human-resources consultancy.

Even with such a boost to its resources, there are doubts about whether the PPF will prove viable in the long run without recourse to the taxpayer. In America the PBGC has been overwhelmed by huge claims from foundering industries such as steel and airlines. “It's become painfully clear that policy towards pensions has become industrial policy,” says Olivia Mitchell, executive director of the Pension Research Council. When this happens, she says, “the system ceases to be insurance and becomes bail-out”.

The immediate danger is that firms may conclude that the load on them is too much to bear. “If you push too hard, employers will give up,” says Robin Ellison, chairman of the National Association of Pension Funds. Already about 70% of DB schemes are closed to new employees. The NAPF is now expecting a second wave of closures, in which firms would stop the future accrual of pension benefits for existing members of DB schemes. Alternatively, they might make accrual less generous, so that each year of future service builds up less benefit.

With so many schemes already closed to new employees, the traditional company pension is a dying species. The worry about the regulator's approach is that if business decides the pressure is excessive it can and will advance that date with the undertaker.

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Citizenship

Quizzical

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Britain tests its immigrants—and the notion of Britishness

AS THOUGH Britain were not hard enough on immigrants, it began this week to subject some of them to a multiple-choice exam. The idea is to test whether new arrivals are prepared for life in a wet country on the outskirts of Europe. It's a challenge, with a 75% pass mark and a long list of potential questions. But the test itself is simple, compared with the arduous task the country has been forced to perform: explaining itself to outsiders.

Other countries' quizzes reveal a breezy confidence about what their nations stand for. America tests new citizens by drawing questions from a sample list of 100 that is heavy on patriotism and constitutional principle. Seven questions are about the flag. Canada's test stresses civic duty, defined in boy-scout fashion: “Give an example of how you can show responsibility by participating in your community.”

Britain's effort is hesitant by comparison. Would-be citizens are tested on three chapters of a booklet, “Life in the United Kingdom”, which is so measured as to be almost apologetic. Two potential questions: how much less are women paid than men? And how many young people have taken illicit drugs? (The answers are 20% and about half, “if sometimes only as an experiment”). The section on politics describes the threat to civil servants' independence and explains the word “spin”. The closest thing to patriotism is an assertion that the nation “works reasonably well”.

Why the lack of patriotic certainties? Sir Bernard Crick, who wrote two chapters of the booklet, explains that the national culture is poorly defined, thanks to the lack of revolutionary heritage or a constitution. Britishness, he says, consists mostly of living in Britain. Instead of ideals, the nation has (unwritten) rules. “If you spill a stranger's drink by accident,” trainee citizens are told on page 101, “it is good manners (and prudent) to offer to buy another.”

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David Blunkett resigns

Curse of the double helix

Nov 3rd 2005
From The Economist print edition

AFP

I won't be back

How a senior minister's private life became political and cost him his job

EVEN before David Blunkett resigned this week from the government for a second time in less than a year, the waning of his reputation had been likened to a Greek tragedy. Certainly some of the elements in the story—power, sex, blindness, ridicule—would have appealed to Sophocles. Yet Mr Blunkett was undone not by hubris, but more private motivations: a failed love affair and a desire to look after the interests of his children.

His departure is a big event in British politics, partly because of his stature. Before he resigned from government last December, after making improper use of his private office to speed up a visa for a nanny employed by his former lover, Mr Blunkett was talked about as a potential prime minister to succeed Tony Blair.

It is easy to see why. He is one of only two high-profile members of Mr Blair's cabinet (John Reid is the other) who combine enthusiasm for the direction in which Mr Blair has taken the Labour Party with an Old Labour past that party activists find appealing. When Mr Blair announced that education would be his government's top priority, Mr Blunkett became education secretary. When Mr Blair was worried about his vulnerability on law and order, Mr Blunkett moved to the Home Office.

Mr Blunkett's second resignation was over a breach of the ministerial code of conduct. The code, which is a guide rather than a binding set of rules, says that for two years after they leave government former ministers should consult an advisory committee before accepting any private-sector jobs. Mr Blunkett failed to do this. At best this was clumsy: Britain has amassed the world's biggest database of its citizens' DNA, under the watch of the department Mr Blunkett had just left. That he stood to make a big profit on shares he bought in the course of his two-week directorship at DNA Bioscience made it look worse.

Unfortunately for the divorced Mr Blunkett, the job also fitted neatly with stories about his private life that have refused to die since he first resigned. He was involved in a dispute over the paternity of a child born to his lover, Kimberly Quinn, the married publisher of a Conservative magazine. And DNA Bioscience provides paternity tests.

The husband of a director of the company also introduced Mr Blunkett to a young-ish woman with a fondness for newspaper confessions, at Annabel's, a posh London nightclub. Her tales did more damage. Eventually Mr Blunkett's public and private lives formed a double helix, making it hard for him to treat the two separately. Some Labour backbenchers could not forgive his taste for glamorous Tory women and his desire to turn a fast buck.

What makes Mr Blunkett's fall from grace sadder is that his modest business activities may have been motivated by an urge to provide for his sons, whose inheritance was being spent on his paternity suit. Two resignations by one of the biggest figures in politics of the past decade go back to the same failed love affair. The Greeks would have found that puzzling.

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The Archbishop of York

That south-north axis, again

Nov 3rd 2005
From The Economist print edition

Kampala charm may keep the Anglicans on talking terms

AP

Get article background

IT IS a long time since a bishop from so far south travelled so far north to sort out the affairs of the English church. Indeed, the only precedent may be the mission of St Theodore, a Greek-speaking prelate from Tarsus (now in south Turkey), who crossed the Channel with an African aide in the year 669, and united England's Christians in a structure that has lasted ever since.

The second position in that structure—that of Archbishop of York, responsible for much of northern England—has just been given to a cleric whose history is every bit as unusual, and un-English, as Theodore's. John Sentamu was born in 1949 in rural Uganda, the sixth of the 13 children of a village priest. He had to walk several miles to school until a teacher gave him a bicycle. As a young Ugandan judge, he fell foul of Idi Amin's dictatorship, whose thugs beat him up, forced him into exile and later killed his mentor, an archbishop. At this month's enthronement in York's ancient minster, African drums may be heard mingling with the organ music.

Before his latest elevation, Archbishop Sentamu was doing a tricky job as bishop of multi-racial Birmingham—a city whose religious life is dominated, at least in some central districts, by Islam. As a defender of all faiths against ill treatment or insult—of the kind he has occasionally endured from British cops—Bishop Sentamu seemed to fight a tough corner rather well, with a gift for eye-catching gestures. He offered his home telephone as a “hot line” for clues after two black girls were murdered. Last spring, he and another bishop observed Lent by walking 218 miles over the rain-swept hills and grimy townscapes of the west Midlands, hobnobbing with Sikhs, Hindus and Muslims as they called at schools, supermarkets and a car factory. With such talents as a racial and religious trouble-shooter, why send him to the sedate environment of a bishop's palace in York, where he will be surrounded by people who are mostly white and well-off?

In fact, the appointment makes sense only in the light of the broader travails now afflicting the Anglican Communion, a world-wide community of 77m believers that Archbishop Rowan Williams of Canterbury is struggling to hold together, despite the growing rift between New World liberals and Third World conservatives, a lobby known as the Global South.

If anybody can heal that rift, it may be a Ugandan who is robust enough in his defence of traditional Christian doctrines to reassure the evangelicals, and charitable enough in his manner to woo some members of the opposite camp. He scored liberal points by opposing the Iraq war and backing the ordination of women—but his appointment was hailed by evangelicals as a counterpoint to the cooler, more cerebral style of Archbishop Williams.

Archbishop Sentamu's recent comments on the touchstone issue of homosexuality have been emollient—stressing that gays and lesbians can “live in Christ” as well as anybody else—while leaving intact the conservative line laid down at the last pan-Anglican gathering in 1998: one that rules out same-sex marriages, or the ordination of non-celibate homosexuals. In the end, charm and bonhomie may not suffice to hold the communion together—but the Sentamu factor could help keep the Anglican family on speaking terms until their next big gathering in 2008.

As well as being a charmer, the new archbishop has a legal training; he can say reassuring things while carefully leaving basic axioms intact. In the words of Simon Barrow, of the religious think-tank Ekklesia, he is “a good lawyer who knows how to build bridges and tear down barriers”.

But be warned—when St Theodore, an earlier envoy of the Global South, arrived in York, the initial result was mayhem: he divided the diocese into four, destroying the power base of its existing incumbent, St Wilfrid. This triggered a feud between two churchmen—only settled, movingly, when both were near death. As he enters high Anglican politics, Archbishop Sentamu may find himself resorting to a similar mixture of scalpel and balm.

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Anti-social behaviour

Dissed

Nov 3rd 2005
From The Economist print edition

Why some draconian laws are acceptable but others are not

Get article background

ON OCTOBER 30th a “secret” government plan to ban drinking on public transport was revealed in several newspapers. The result was immediate outrage. Journalists, opposition politicians, even (anonymously) some government ministers condemned the plan. A scrambled exit has already been made, but the episode reveals much about Britons' peculiar attitude to crime and the law.

Draconian laws against bad behaviour are hardly unknown in Britain. Courts can, for example, issue an Anti-Social Behaviour Order (ASBO) to anybody over the age of ten who causes “harassment, alarm or distress” to others, whether or not a crime is involved. The burden of proof is low—hearsay evidence is admissible in court, for example—but the consequences for the perpetrator are severe. An ASBO can be used to prohibit someone from entering an area, from saying certain words, even from dressing in a particular way. Break the order, and the penalty is up to five years in prison. These powers are popular: MORI, a pollster, finds that they are opposed by just 4% of people.

Hostility to a drinking ban is especially odd given that drunkenness on trains and buses is a problem. Martyn Ripley of the British Transport Police reports an increase in drunken violence and disorder on his patch, which includes Manchester and Liverpool. While the vomiting and rowdyism that occur on weekend nights hardly amounts to “a Wild West situation”, says Mr Ripley, it upsets other travellers.

It seems, too, that new laws are needed. Despite all those ASBOs, a record 2,643 of which were handed out last year, anti-social behaviour is thought to be as common as ever. The British Crime Survey shows that the proportion of people who thought their neighbourhood suffered from it actually increased slightly between 2003-04 and 2004-05.

So why not ban drinking on public transport? Passing laws against specific things is how most countries tackle petty annoyances. It has the advantage of clarity: if people know that something is an offence before they commit it (not so with anti-social behaviour laws), they might be less likely to misbehave in the first place.

Politically, though, clarity is a drawback. Mark Oaten, the Liberal Democrats' home affairs spokesman, opposes an alcohol ban precisely because it would affect anyone who takes public transport. A law designed to tackle a small number of rowdy drunks, he complains, would prevent commuters enjoying a hard-earned tipple at the end of the day.

Mr Oaten probably has his finger on the national pulse. Britons are keen to crack down on anti-social behaviour. There was little outrage over another proposal, also revealed on October 30th, to

confiscate the homes of persistent offenders. But it is not good politics to say exactly what constitutes anti-social behaviour, or to suggest that some pleasures ought to be put out of everybody's reach. Britons want their hedonism to be unrestrained; they just do not want to be subjected to other people's unrestrained hedonism.

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Music

Brassed off

Nov 3rd 2005
From The Economist print edition

Orchestras must scrimp and save

CUE sweeping strings. Some of Britain's best orchestras could cease to exist if they have to pay a backdated tax bill, according to the Association of British Orchestras (ABO). At the moment, orchestras do not pay National Insurance (a tax on employers) when they employ a freelance violinist. But according to the Inland Revenue, orchestras ought to have paid the full 12.8% of their freelancers' salaries to the taxman, since a change in the law in 1997 designed to benefit "resting" actors. The difference, according to the ABO, is £33m. The largest of Britain's 15 symphony orchestras have turnovers of only £8m-10m, so it's not hard to see why they are worried.

Running an orchestra in Britain is hard going. French, German and Spanish orchestras get respectively 60%, 80% and 100% of their cash from the state. The big London orchestras, by contrast, get 18% of their income from the Arts Council, a quango, and less money from benefactors than American orchestras do. Russell Jones, a director of the ABO, describes his members' finances as "stable but almost precarious". One way to keep costs down is to employ freelancers.

Britain's regional orchestras do have salaried players on their payrolls. But even the Birmingham Symphony Orchestra has to resort to freelancers when the first oboist is ill. Several of the main orchestras in London (where there has always been more demand for the best musicians), including the London Symphony Orchestra, are made up entirely of players who are technically freelance. With such well-known orchestras under threat, the taxman will probably relent.

A second challenge to the bottom line comes from a loss of revenue from recordings. When music lovers were replacing their records with CDs, money from recordings helped to keep orchestras solvent, but no longer. Britain's resourceful orchestras have a strategy for dealing with this too. Live recordings, which are cheap, owned by the orchestras and priced modestly, are selling well. LSO Live, the London Symphony's label, went into profit two years earlier than expected. "Our members work twice as hard as European orchestras and certainly harder than the Americans," says Mr Jones defiantly. To avoid falling silent, they'll have to.

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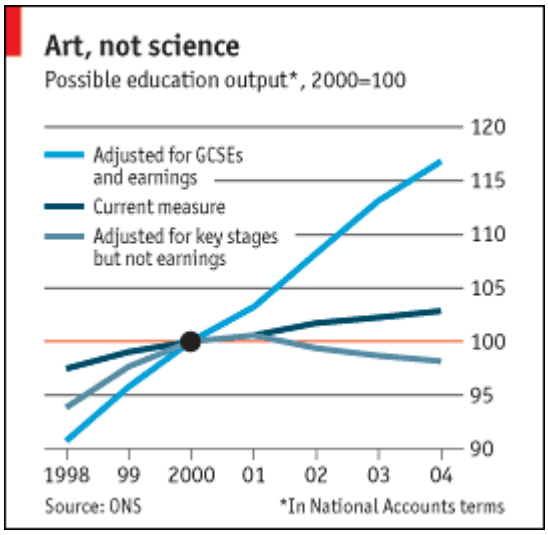
Official statistics and education

Pick a number, any number

Nov 3rd 2005
From The Economist print edition

Government performance is getting better—or worse

Get article background



IT'S not often that a statistician suggests you should stop trying to measure something. But on October 31st, the Statistics Commission—an independent body that monitors official statistics—published a draft report on the government's 102 most important performance targets, which concluded that many are seriously flawed and that targets are inappropriate for grappling with what in some cases are really statements of aspiration.

Some of the targets were criticised for being incomprehensibly complex (the Department of Trade and Industry's target for the British research base and innovation performance combines 23 separate indicators, each with its own target, and four event "milestones"), some because they would be missed if a single case falls below a given threshold (for example, if even one school out of 3,400 fails to bring half its pupils up to scratch in each of English, maths and science) and some because the necessary data don't exist. On occasion, the report says, "the desire to present a government aspiration in the form of a quantified target leads to the creation of targets that seem artificial or 'forced'."

On the same day as the commission brought out its report, the Office for National Statistics (ONS) published an article exploring possible changes to the way inputs and outputs are measured in schools. State education used to be valued at whatever the government had spent on it, no matter how much cleverer children became or how much it cost the taxpayer.

But in 1998 the ONS started to make direct estimates for much government output, including state-funded education. And, embarrassingly for the government, it looked as if the money it was pouring into education was going to waste. Inputs have been going up by around 2% a year for the past ten years, but outputs have been going up by only 1% a year, meaning productivity has been falling by about 1% a year.

Today's measure of output is based on the number of students, with a "quality adjustment" of 0.25% a year (to reflect the increase in the share leaving school with at least five GCSEs at grade C or above). The ONS article suggests that the quality adjustment should instead vary from year to year to reflect either the number of students reaching the GCSE threshold, or an overall measure of students' progress at key educational stages. The first leads to the measure of output increasing by around 3% a year, the second to it increasing by less than 1% a year.

The article also looks at using an “earnings adjustment” to estimate the changing value of education, as distinct from its changing quality, saying that as society as a whole becomes richer, the returns to education increase. The rate suggested is 1.5%, which is an estimate of long-term growth in real earnings.

The trouble is that different combinations of these adjustments lead to very different results. At one extreme, education productivity may have fallen by around 2% a year since 1998; at the other, it may have increased by the same amount.

So which method is right? The Department for Education and Skills has already said that it thinks productivity should be calculated using a quality adjustment based on GCSE attainment and an earnings adjustment of 1.5%. As it happens, that is the combination giving the highest measure of productivity.

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Freedom of information

Taxi affairs

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Scotland's top Tory takes a ride

SCRUTINY is something politicians have to put up with. But this week the Scottish media demonstrated that they have a potent new spyglass—using freedom of information laws to examine expense accounts. On October 31st David McLetchie resigned as leader of the Conservative Party in the Scottish Parliament, blaming endless media questioning of his expense claims for taxis.

There was some justice in this. Mr McLetchie was the man who first sent reporters down this exciting new trail, when he harried Labour's Henry McLeish into resigning as first minister of the Scottish Executive in 2001. Mr McLetchie, a working-class lad who rose to become a successful lawyer, forced Mr McLeish to admit that "in a muddle, not a fiddle", he had claimed too much in office-cost expenses when he was an MP.

No wonder the press was rapt when it learnt earlier this year that Mr McLetchie had the highest taxi bill of any MSP, of £11,500 spent over five years. Requests for details produced a list of the fares but the destinations were blacked out—for security reasons, the parliamentary authorities said.

Journalists appealed to the Information Commissioner, who ruled that all the details must be released. A flood of stories ensued, suggesting that Mr McLetchie had used public money for taxi journeys on party or private business, and not just for parliamentary or constituency work. Mr McLetchie could explain many items, but about £5,000 of taxi chits had no destination listed and he decided enough was enough.

The next Scottish elections are 18 months away. Voters are worried about crime, rapidly rising public spending and only slowly improving public services. The Tories ought to be strong on such things, but their message was being lost in the taxi-chit paper-chase.

Fresh from claiming Mr McLetchie's scalp, journalists have so deluged the parliament with inquiries about all 129 MSPs' expenses that George Reid, the presiding officer, has decided every jot and tittle will be published on the parliament's website. MSPs' expenses, which annually average £61,240 (including office and staff costs), are only about half those of their Westminster counterparts, yet details of Westminster expenses are beyond the reach of freedom of information requests. Can that be right?

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Bagehot

A Blunkett judgment

Nov 3rd 2005
From The Economist print edition

The sad fate of David Blunkett is a warning for Tony Blair

Get article background

WHAT finished off David Blunkett was that he had exhausted the good will and personal sympathy both of cabinet colleagues and the bulk of Labour MPs. Despite the prime minister's insistence on Wednesday that Mr Blunkett had left the government “with no stain of impropriety” and that he could have carried on, even Mr Blair's patience with the work and pensions secretary must have been wearing thin.

Mr Blunkett's disdain for the ministerial code of conduct and willingness to take on a potentially lucrative two-week directorship at an obscure DNA-testing company confirmed what many people had already begun to think: that the turmoil and disappointment in his personal life had fatally eroded his once-sound judgment (see article). He was thus no longer in a position to sponsor the radical green paper on welfare reform that Mr Blair had been pressing for. To judge by his frantic attempts to get Number 10 to go easy on making draconian changes to the incapacity-benefit rules, Mr Blunkett suspected as much himself even before last weekend's revelations.

What should worry Mr Blair is the extent to which the whole sorry business calls into question his own judgment almost as much as Mr Blunkett's. Mr Blair must have realised that bringing the former home secretary back into government so swiftly was a big risk. But it was one the prime minister was willing to run, perhaps because he reckoned that nobody else could so effectively carry through a vital part of what is now talked about as Mr Blair's “legacy agenda”. In the past, Mr Blunkett had shown he was big and bold enough to stand up to Gordon Brown. His own life story in overcoming a severe physical handicap insulated him (and thereby Mr Blair) against the inevitable charge from the left that cajoling recipients of incapacity benefit back into work was inhumane. Finally, Mr Blair may have cynically calculated that, because Mr Blunkett owed

everything to him, he would be pliable.

In other words, damaged and accident-prone though Mr Blunkett was, Mr Blair was almost carelessly prepared to take a punt on him. Labour MPs are unnerved by the impression Mr Blair gives these days of feeling unconstrained by normal political caution. Fearful that he is running out of time and liberated from having to face the voters again, Mr Blair says he is determined to do the things in the two or three years remaining to him that he wishes he had done before. Mr Blair's remark to the party conference a few weeks ago—“every time I've ever introduced a reform in Government, I wish in retrospect I had gone further”—was a signal of his intent.

Ministers and backbenchers, whose ambitions and livelihoods depend both on Mr Blair's successor and the condition of the Labour Party when it next faces the electorate, are bothered that the pace that Mr Blair has set seems to them to be governed more by his personal timetable than the long-term health of the government. They point out that Mr Blair's shrinking time horizon is his problem, not theirs. And, they add, it should not be the excuse to try and impose policies on the party that he had not previously dared to. When Mr Blair surprised everyone by announcing eight months before the last election that it would be his last, he did so because, having spent nearly all his political capital on an unpopular war, he felt vulnerable and hoped that he would win some breathing space. It worked, but it did not, say his critics, give him the freedom of action he is now claiming.

There are real dangers here for Mr Blair. He may not have to face the voters again, but he will achieve little of what he wishes unless Labour MPs kick the habit of rebellion. That was tolerable when the government had parliamentary majorities of more than 160, but no longer now that Labour's majority is 66 (or 71 when allowance is made for the non-voting Sinn Fein MPs). Proof of the government's vulnerability came on Wednesday evening when its majority fell to one in a vote on controversial anti-terror legislation. Given that at least 20 MPs can be relied upon to vote against the government on almost any issue dear to Mr Blair's heart, only another 20 need to change their colours at any time to thwart the prime minister.

And, the way things are going, that should not be too difficult. In spite of some watering down, last week's education white paper was disagreeably strong medicine for the many Labour MPs who cling to the ideal of comprehensive schools and who see local education authorities as a force for good. John Hutton, Mr Blunkett's able but low-key successor, should prepare himself for a rough ride if Mr Blair gets his way with welfare reform. Before Christmas, the next stage of the health-service revolution will be revealed, no doubt confirming the worst fears of Labour traditionalists. Add into the mix Mr Blair's determination to take strategic decisions about updating the British nuclear deterrent and laying the ground for a new generation of nuclear power stations, and the potential for serial rebellion is clear.

Après Tony

Is there anything Mr Blair can do to head off trouble? Two things would help. The first is largely a matter of presentation. Mr Blair would almost certainly get more of what he wants done if he talked less about “pivotal moments” and more about building on existing policies. If you deliberately use language that frightens the horses, don't be surprised when they bolt.

The second, and most critical, is that he must somehow banish the growing suspicion within the party that he is indifferent to its future once he has gone. Nothing could be more lethal than the whispered suggestion by some Blairite ultras that his precious legacy might be safer with the Tories' David Cameron than with Mr Brown. Can Mr Blair do either of those things? He'd better try. If he doesn't he may find himself with as few political friends as the tragic Mr Blunkett.

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The hidden wealth of the poor

Nov 3rd 2005
From The Economist print edition

Financial services are at last spreading from the rich to the developing world—and even making money, writes Tom Easton (interviewed here)

IN RICH countries, financial services on the whole work remarkably well, despite the exotic salaries, the crackpot deals and the occasional bust. The vast majority of people have access to interest-bearing savings accounts, mortgages at reasonable rates, abundant consumer credit, insurance at premiums that reflect the risk of losses, cheap ways of transferring money, and innumerable sources of capital for funding a business.

By contrast, financial services for poor people in developing countries—a business known as "microfinance"—have mostly been awful or absent. With no safe place to store whatever money they have, the poor bury it, or buy livestock that may die, or invest in jewellery that may be stolen and can be hard to sell. Basic life and property insurance is rarely available. Home loans are costly, if indeed they can be found at all. For many people, the only source of credit is a pawnshop or a moneylender who may charge staggeringly high interest and beat up clients who fail to pay on time. In the Philippines, lenders who zip from town to town on motorcycles expect six pesos back for every five they lend. That translates into an annual interest rate of over 1,000% on a loan for a month.

For workers from poor countries who venture abroad to earn a better living, sending money home to relatives can be hugely expensive. Such remittances have become an important source of income in many developing countries, dwarfing other inflows of capital from overseas such as foreign direct investment and multilateral aid. But if the money is being sent, say, from America to Venezuela, charges can amount to as much as 34% of the sum involved, according to Dilip Ratha of the World Bank.

Why are the poor so badly served? The easy answer, that people who have little money do not make suitable clients for sophisticated financial services, is at most a half-truth. A better explanation, this survey will argue, is that the poor have been hurt by massive market and regulatory failure. Fortunately that failure can be, and increasingly is being, remedied.

In most developing countries, the barriers to providing financial services for the masses are all too clear. Inflation tends to be high and volatile; government is often incompetent; and the necessary legal framework for financial services is often missing. Property laws can make it impossible for poor borrowers to use assets such as their home as collateral for loans.

In the past, many countries have outlawed “usury”, and today many Islamic countries prohibit the charging of interest. Governments in developing countries often impose caps on the interest rates charged on loans for the poor. Despite their popular appeal, such caps undermine the profitability of lending and thus reduce the supply of loans.

Incomplete and erratic regulation of financial institutions has also undermined the confidence of the poor in the financial services that are available. When they can find an institution that will accept their tiny deposits, it often lacks the sort of government deposit insurance that is routine in rich countries, so when a bank goes under, savers suffer. For example, Indonesia's PT Bank Dagang Bali, once known for its work with poor clients, was closed by regulators last year after it was discovered to be insolvent and riddled with fraud. Many savers did not get their money back.

Corruption is also commonplace in many developing countries. A recent study by the World Bank found that in two poor states in India where the financial system is largely controlled by the government, borrowers paid bribes to officials amounting to between 8% and 42% of the value of their loans. Corruption raises the cost of every financial transaction, allows undesirable transactions to take place and undermines consumer confidence in the financial system. This, and the related curse of cronyism, explains why access to financial services in countries where the state has control over the financial sector is poorer than where it does not.

Inadequate basic public services add to the burden on financial firms. SKS, a fast-growing microfinance institution in India, has had to build back-office systems that can work on two hours of power a day; it closely monitors voltage when its computers are running and keeps a diesel generator on hand. Many others simply give up on the idea of modern technology and continue to use paper instead. This makes them vulnerable. The tsunami in December 2004 wiped out financial records at many small Indonesian banks.

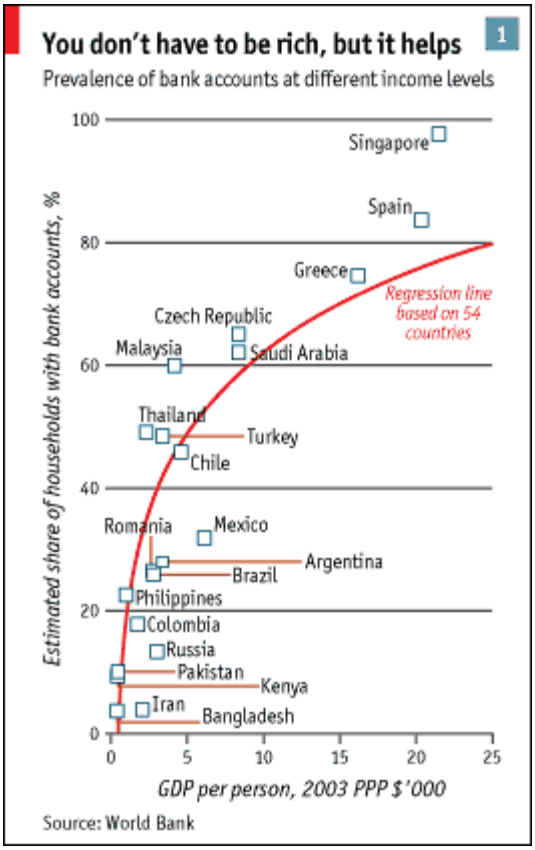
But not all the blame goes to poor-country governments. Financial-services firms too have failed to do enough to deal with the lack of the sort of data (for example, about a client's financial history) that are taken for granted in rich-country financial systems, and to find ways of reaping economies of scale. Many have simply dismissed the possibility that serving the poor might be a viable business.

The start of something big

In recent years, at least in some parts of the world, this bleak picture has begun to change, first in credit, then in savings and more recently in remittances. Even insurance—not only the basic life sort but also more sophisticated forms for things like cattle and weather risk—is gradually being introduced.

These changes have recently received a lot of attention in policymaking circles. Grand claims have been made that credit can end poverty. A World Bank report by Thorsten

Beck, Asli Demirguc-Kunt and Soledad Martinez published last month shows a strong correlation between lack of financial access and low incomes (see chart 1). Earlier research by the first two authors and Ross Levine concluded that a sound financial system boosts economic growth and particularly benefits people at the bottom end of the income league. A long-term study in Thailand by Robert Townsend of the University of Chicago and Joe Kaboski of Ohio State University showed that families with access to credit invested more, consumed more and saved less than those without such access.



What makes microfinance such an appealing idea is that it offers "hope to many poor people of improving their own situations through their own efforts," says Stanley Fischer, former chief economist of the World Bank and now governor of the Bank of Israel. That marks it out from other anti-poverty policies, such as international aid and debt forgiveness, which are essentially top-down rather than bottom-up and have a decidedly mixed record.

Studies by Stuart Rutherford, who runs an experimental bank that provides loans and takes deposits in the slums of Bangladesh, show that the poor attach great value to having a safe place to keep money and some means of providing for life's risks, either through savings or, better still, through insurance. When financial services are available to them, the poor, just like the rich, snap them up.

In one sense, microfinance has been around for a long time. What is now generating so much hope and excitement is less the discovery of some entirely new way to deliver financial services to the poor than the effect of the rapid innovation that has taken place in the past three decades.

From pawnshop to Citigroup

The oldest financial institution in the Americas is a pawnshop on Mexico City's central square. Set up in 1775 under an edict by the Spanish crown to assist people in financial trouble, it is called Monte de Piedad, variously translated as the mountain of mercy or the mountain of pity. Pity or mercy come in the form of cash in return for valuables. Unclaimed items end up for sale in a series of glittering rooms near the main banking hall.

By transforming trinkets into capital, pawnshops perform an important (if under-appreciated) service, but they have three limitations. They advance cash only to people with assets. Their loans are based on the value of collateral, not of a business venture. And the valuables held as collateral cannot be used to fund businesses, as banks' cash deposits can.

There have been two notable attempts to find alternatives. One has been the creation by developing-country governments of state banks, particularly to finance the rural poor. These have mostly been a disaster. The other, much more successful one involved a number of organisations extending uncollateralised loans to very poor borrowers. In 1971, Opportunity International, a not-for-profit organisation with Christian roots, began lending in Colombia. ACCION International, also not-for-profit, made the first of what it called "micro" loans in 1973. Grameen Bank started in

1976 and soon became extraordinarily famous for offering “microcredit” to women in small groups.

To qualify, Grameen's customers had to be extremely poor, probably earning less than a dollar a day. To overcome the lack of collateral or data about creditworthiness, group members were required to monitor each other at weekly meetings, applying varying degrees of pressure to ensure repayment. As loans were repaid, people were allowed to borrow more. The group replaced the security that pawnshops gained from collateral. The model is not perfect, but it does have real virtues and has since spread around the world.

Why did these organisations start with providing credit? They assumed that poor people were unable to save, and that their sole need was for capital. But that was not the whole story. When BRI, a failing state-controlled rural lender in Indonesia, was transformed into a bank for the poor in 1984, it offered not only the usual loan products but also a government-guaranteed savings account with no minimum deposit. This has been an extraordinary success: BRI now has 30m savings accounts.

Nobody knows how many institutions are providing microfinance in some form, but the number is certainly huge (see article). They are growing fast and serving a vast number of people in absolute terms, although still only a small proportion of the billions who earn only a few cents a day. Local banking giants that used to ignore the poor, such as Ecuador's Bank Pichincha and India's ICICI, are now entering the market. Even more strikingly, some of the world's biggest and wealthiest banks, including Citigroup, Deutsche Bank, Commerzbank, HSBC, ING and ABN Amro, are dipping their toes into the water.

The downsides

Not everyone has been pleased with the prospect of better financial services for the poor. Islamic fundamentalists have bombed branches of Grameen in Bangladesh and attacked loan officers of other institutions in India. Maoists have looted microfinance offices in Nepal. The head of a microfinance effort in Afghanistan was murdered, possibly by drug traders.

To drug lords in Afghanistan, the availability of credit is unwelcome because it gives a choice to farmers who were previously forced to grow poppies for want of other ways to finance their crops. For the elites in closed markets running inefficient monopolies, credit raises the prospect of future challenges from entrepreneurs. For radical Muslims, it means that women (who in many countries make up the bulk of microfinance borrowers) are able to run viable businesses and become independent. And for everyone in poor countries, credit can mean social upheaval as merit and enterprise replace inheritance, family ties and position.

Nor does microlending always have a happy outcome. The clients of K-Rep, an excellent Kenyan microfinance bank in a small town on the fringes of Nairobi, are a pretty resourceful lot, but when the government stopped repairing roads, picking up rubbish and spraying for malaria, some were at their wits' end. Drainage in the marketplace was plugged by uncollected garbage and customers stopped coming. Maria Njambi, a single mother with a ten-year-old child, used to have a viable business selling fruit and vegetables she bought with credit from K-Rep, but she had to watch her inventory rot and has stopped repaying her loan. She is not alone in her misfortune. A report in 2002 by CARD, a microfinance organisation in the Philippines, offers the following explanation for borrower attrition: “It is a tragic fact that over time, husbands will fall sick, *sari-sari* [variety] stores will be robbed, harvests will be poor and children will die.”

Yet microfinance institutions typically claim extraordinarily low loan losses of 1-3%, a bit better than the rate for big banks in rich countries and much better than for the big credit-card

companies. Given the difficulties facing businesses in poor areas, some critics question the accuracy of these figures. Many of the banks lending to the poor are not-for-profit organisations whose accounts are rarely scrutinised by outsiders. Much of their capital has been provided by governments or philanthropists, and often does not have to be repaid, so perhaps microfinance institutions are being quietly lenient with their customers. Indeed, large-scale defaults in microfinance may go unreported. The Townsend-Kaboski research project in Thailand informally tracked hundreds of microfinance institutions and found that in the five years before the Asian financial crises, 10% failed and a quarter stopped lending.

So there is room for scepticism, but also plenty of reason for hope. The biggest of these is just how much progress the industry has made in the past 30 years.

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What do you know?

Nov 3rd 2005
From The Economist print edition

A beginner's guide to microfinance

MICROFINANCE may be intended for the masses, but its vocabulary can be understood only by professionals, and then only up to a point. The industry is so fragmented as to be virtually unfathomable. There is not even a proper definition of the term, which could mean anything from what a village priest provides when handing out alms to what state banks and credit unions offer to their least affluent clients. The coveted title of a genuine “microfinance institution” from a “practitioner” may owe less to what the institution does than to its public-relations skills. Fortunately none of this matters to the customers, who simply want a service that makes their lives richer.

Nobody knows even roughly how many microfinance institutions there are. Indonesia alone says it has in excess of 600,000, and Bangladesh and Uganda too claim to have many thousands. Even on stricter criteria, such as recognition by a regulator, Indonesia alone has perhaps 60,000 finance companies that provide credit of one sort or another, often to people who have very little income and almost no assets. Self-professed experts distinguish between institutions providing consumer finance (which they do not count as microfinance) and business finance (which they do). But how do you classify the purchase of a stove that is used for cooking both the family meals and the food for sale on a tiny stand? Or a motorscooter that serves both as a delivery vehicle and as family transport? For people who have very little, money and assets are fungible.

The foggiest place in the industry is “on the ground” (another favourite microfinance term), where familiar words suddenly become oddly unintelligible. An item labelled “profit” lets you keep mum about the losses transferred to a money-losing charity affiliate. An “operationally sustainable” business is one that can pay for its running costs but not its capital, which is often the largest single expense for a financial firm. But the worst thing are the acronyms, which make learned analyses of microfinance next to unreadable. All this may sound trivial, but industry practitioners seem to care deeply.

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From charity to business

Nov 3rd 2005
From The Economist print edition

Panos

Can I borrow a lollipop?

In its short history, the microfinance industry has undergone profound changes

TO ANYONE familiar with banking in the rich world, the world of microfinance can seem rather odd. The main providers have not been motivated by anything as straightforward as making money, at least until recently. The core of the industry today consists of some three dozen multinational networks of microfinance providers, which despite their superficial similarities and inspirational rhetoric compete fiercely and fight over everything.

The main areas of strategic disagreement are whether the financial needs of the poor are best met by group or individual loans; by market or capped interest rates; by catering for all the poor or only the very poorest; by concentrating on credit only or offering savings accounts and insurance too; and whether financial services should be provided alone or in conjunction with education, health care and, in a few cases, religion.

The biggest networks include Opportunity International, FINCA, ACCION, ProCredit, Women's World Banking and arguably Grameen (which has no formal ties to other banks but a “replication” programme that it says encompasses more than 100 institutions around the world). There are also national networks, regional networks and even networks of networks, each with their own set of institutions and strongly held views.

At one end of the spectrum are those organisations and networks that, by intent, are barely profitable and concentrate on providing credit, such as Grameen and most of FINCA's and Opportunity's operations. They offer relatively lenient repayment terms and interest rates that do little more than cover costs. Typically, these groups are not-for-profit, or owned by customers or

by investors of the religious and philanthropic sort, rather than by shareholders seeking a financial return.

Beyond their core operations in financial services, some of these institutions are also involved in a range of other activities, both charitable and for-profit. Grameen Bank has a loose relationship with a variety of other companies, including a highly profitable mobile-phone business that has been praised for providing jobs for women but criticised for charging excessive rates.

Rather than pursue profit, microfinance providers at this end of the spectrum often seek to be “sustainable”, a flexible concept that can mean anything from covering all costs to covering all costs but capital. However tenuous the “sustainability”, there seem to be plenty of donor funds, particularly for institutions that can generate lots of good publicity. During 2004 the big development-aid agencies committed about $1 billion to microfinance, according to CGAP, a donor consortium affiliated to the World Bank. Further significant sums have come from private hands. Added to that must be the benefit of very low-cost capital and free technical assistance.

As these financial institutions have grown, however, demand for their funds has often expanded beyond what can reasonably be obtained from donors and special funding deals. Retained earnings help; deposits, if they can take them, help far more, but still not enough. A growing number of microfinance institutions, taking their cue from the success of banks in developed countries, have concluded that the best way to reach the vast number of poor people in the world is to become profitable and operate much like conventional rich-world financial firms. Ultimately that will include things like issuing debt and equity and securitising loans.

Only this way, the institutions argue, will they be able to raise capital in sufficient quantity, at sufficiently low cost and with sufficient speed to transform microfinance from an interesting niche into a ubiquitous service. This argument is beginning to convince a growing number of policymakers interested in development and poverty eradication, who until recently would have regarded trying to profit from the poor as inherently evil.

Time for ACCION

The evolution of microfinance from a charitable social service into something resembling modern commercial banking can be seen in the work of ACCION International, a network of financial institutions based in Boston and Washington, DC, with 27 loosely affiliated members in 22 countries and direct investments in ten. ACCION has an odd history. It was founded in 1961 by Joe Blatchford, a young law student and accomplished tennis player who was sent on a goodwill tour of Latin American cities by the American government. Appalled by the poverty he witnessed, he created an aid group to build schools, install electricity and the like.

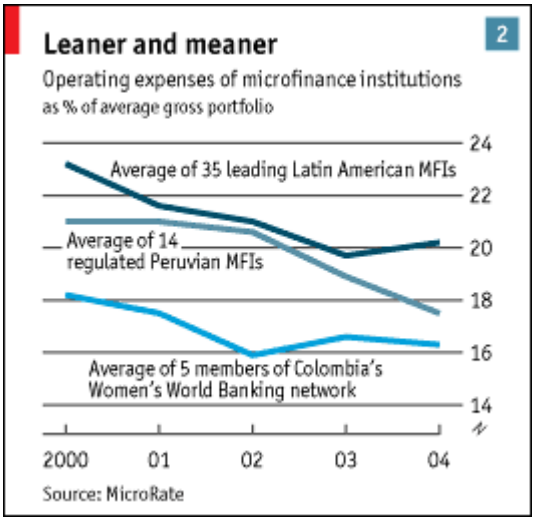
An experiment in Brazil in 1973 played an important part in defining ACCION's future role. The Brazilian unit kept clear of the usual development-agency activities, instead concentrating entirely on providing what at the time were called “micro” loans. Initially, the separation of finance from social services was controversial. But slowly a consensus has begun to form, particularly in Latin America, that this kind of specialisation makes it easier to build efficient (and therefore sustainably helpful) financial institutions.

Early on, financial institutions affiliated to ACCION offered “solidarity loans”—small loans to groups of five people that were collectively guaranteed. Variations on this model remain essential to Grameen, FINCA and many smaller microfinance providers. Each member of a group has a tiny amount of money allocated to him or her, and as they collectively meet their obligations the members establish a credit history that allows them to increase the size of their loans.

There are virtues to this model, notably the way that social pressure from group members encourages repayments and avoids the twin problems of moral hazard (an unwillingness to repay) and adverse selection (being stuck with bad payers who inflate costs for everyone). Credit screening costs the lender next to nothing. Group meetings may also have other advantages, such as the sharing of clients and effective business techniques.

Even so, a growing number of the institutions tied to ACCION soon discovered limitations to the group-lending model. Over time, businesses financed by group members grew at different rates, and so required different amounts of capital. The members whose businesses grew fastest felt constrained in what they could borrow, and those whose businesses grew more slowly found themselves guaranteeing big debts for other people. The meetings themselves became a problem, consuming time members wanted to devote to their businesses. And, perhaps most importantly, as group members developed personal credit histories through their loan payments, the need for collective guarantees disappeared.

At the beginning, simply providing credit was reason enough to start a small not-for-profit financial-services organisation. As time went on, clients started to demand more products, particularly savings accounts, but regulators were reluctant to grant the necessary banking licences to microfinance institutions that had no clear ownership structure and little prospect of profits. Success also increased the demand for capital.



In a major strategic change, in 1992 Prodem, a small Bolivian not-for-profit organisation in the ACCION network, turned part of its operations into BancoSol, a normal bank run on commercial lines, albeit still seeking to serve the poor. The transition was marred by bitter internal fights. Interest rates charged on loans were initially set at 65%. Yet in the end the transformation worked, enabling the bank to grow and to bring down its interest rates by two-thirds. True, BancoSol has not been an unqualified success, but it has remained viable even as Bolivia has suffered huge financial problems. It is now seen as a model for similar transformations in Latin America, Africa and Asia, with ACCION playing a critical role in managing the change.

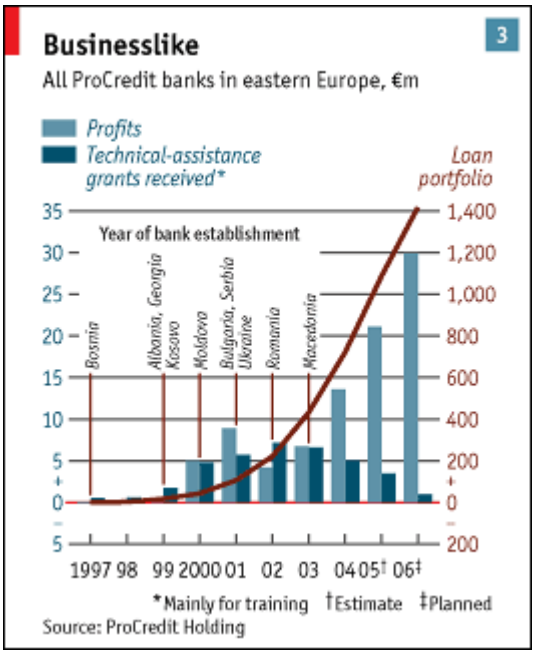
Several other microfinance groups followed ACCION's lead. FINCA, another organisation with affiliates all over the world, last summer created a number of for-profit subsidiaries, which allowed it to tap outside investors and almost double its capital. But the best example of this trend is a Frankfurt-based organisation now known as ProCredit.

A credit to the industry

Like ACCION, ProCredit came to banking by an indirect route. Its founder, C.P. Zeitinger, began his career in the 1970s by examining Latin American financial institutions that were getting money from German development agencies. When he pointed out that the whole thing was a waste of money, he was, in effect, fired by the agencies . After working on the conversion of various not-for-profit institutions into banks in the 1990s, as ACCION had done, Mr Zeitinger became convinced that it would be cheaper and faster to start financial institutions afresh. Backed by investment from various development agencies such as the World Bank's International Finance Corporation, he started out in Bosnia and Hercegovina in 1996 and has since founded banks in 14 other countries and taken a controlling position in four others.

The most recent addition came this month in Congo, which speaks volumes about what ProCredit considers an opportunity. There is vast potential (60m people and only 50 bank branches), coupled with many evident risks (decades of intermittent war; nearby genocide; no local currency; frequent famine; sporadic government coups). Into this chaos, ProCredit introduces a consistent model (with minor local adjustments) that relies on the company having full control: “We are not polite, we know what we want, we have it our way,” explains Mr Zeitinger.

The back-office systems of ProCredit banks and its branding are identical around the world, and supervised by some of the same people. Their credit systems depend on careful analysis of the cashflow and business prospects of every client, and even competitors concede that they are unusually good at detecting problems before loans are granted. ProCredit does not do group lending, partly because Mr Zeitinger thinks it only really works in rural settings where people are genuinely close, and partly because he feels that individuals should not have to be responsible for the failures of others but should be judged on their own merits. ProCredit also expects clients to come to its branches to repay loans, rather than sending out collection agents to villages, as many other microfinance institutions do.



ProCredit's experience shows that there is a pent-up demand for credit and saving in even the poorest corners of the world, and that poor people will seek out institutions that provide these things effectively. Its growth has been remarkable. It now has 7,500 employees, of whom 2,500 were hired in the past year. With $2 billion in assets, it remains tiny by multinational banking standards, but it is not insubstantial. Fitch, a leading rating agency, recently gave it an investment-grade rating, noting that it had operated successfully in some extremely difficult environments. Even in Haiti, where it has lost money in euro terms because of a 30% currency devaluation, it continues to operate profitably in local money. “Any anarchy is frightening,” says Mr Zeitinger. “But it is an opportunity as well, because it allows you to impose your own structure and grow faster and become more important and become more profitable.”

ProCredit has not yet left the not-for-profit world entirely. When it moves into a new country, it often accepts subsidies for the first two or three years, a time of high start-up costs and little revenue. But its good performance is now opening up other sources of funds: it recently raised $54m in the German bond market with the help of Deutsche Bank at an interest rate of just over 5%. Its banks in three countries have been able to raise money via local bank syndicates. It has also seen a huge growth in deposits.

In the not-too-distant future, Mr Zeitinger foresees ProCredit becoming entirely independent of international financial organisations. In some poor countries, he hopes to be able to borrow and lend at rates below those for the government's own debt (which in well-run countries is usually the best-quality credit), reflecting his clients' and his firm's superior record of repayment. That would demonstrate the virtues of normal banking. But what do the mainstream banks themselves make of microfinance?

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Giants and minnows

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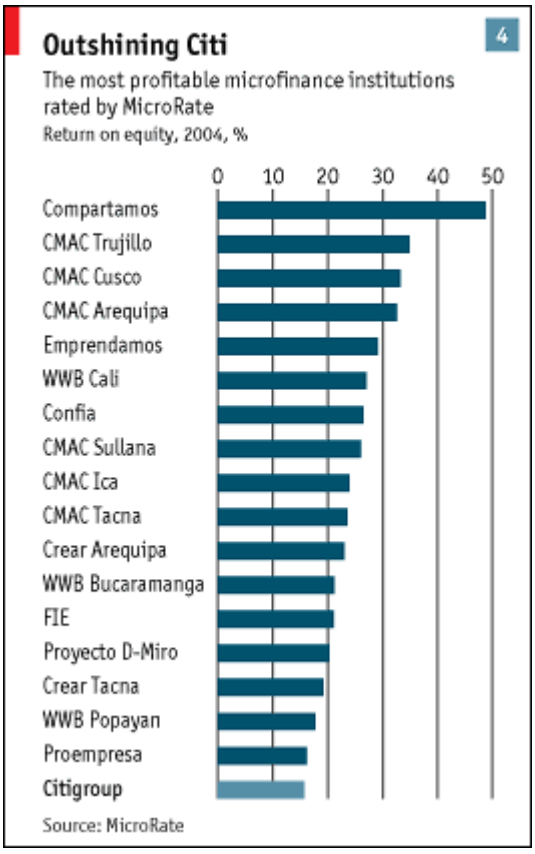
Big banks are discovering the market for poor customers

ONE of the most encouraging trends in microfinance is that the world's largest banks and insurers are becoming interested. At a minimum, they can do something that small local institutions cannot: move money around the world through their own systems, and tap and raise huge pots of capital. They can also reduce the risk and increase the liquidity of small institutions by packaging and reselling their loans, and even provide savings products through tiny institutions.

So-called “bottom of the pyramid” strategies (named after a bestselling book called “The Fortune at the Bottom of the Pyramid”, by C.K. Prahalad) are currently in vogue among the world's leading companies in many industries. The idea is that big business has so far ignored a huge number of people who have very little money but nevertheless represent a potentially lucrative market. The big banks have noticed, but they are moving slowly and with great caution. ICICI Bank of India reckons that providing $1.3m in loans to microfinance clients currently requires 40 times more manpower than a corporate loan of the same size.



Typically, the big global financial institutions are moving into microfinance via their corporate-responsibility or community-development departments, not their core for-profit banking operations. Most of them are pleased to do something that may win them good marks from their usual critics in non-governmental organisations. But they are also worried that if they turn microfinance into a real business, they will be slammed for profiteering from the poor. And there are people working in the big banks who honestly do not believe that microfinance can, or should, be a business.

One exception is Citigroup, which happily proclaims that, leaving aside its philanthropic activities, it is also getting into microfinance for its potential profits. But the foremost example is Bank Rakyat Indonisia (BRI). Founded by the Dutch in 1895 as an institution for the elite, by the 1970s it had become yet another badly run state bank with an impossible mandate. It was supposed to help farmers to increase rice production, but the government reserved the right to approve borrowers and required BRI to pay more for its deposits than it received for its loans. Not surprisingly, the bank did not bother to collect deposits, and many borrowers did not bother to repay their loans. According to a report by Marguerite Robinson of Harvard University, an analysis of BRI's 3,600 lending units concluded that not a single one of them made money.

Facing disaster, in 1983 the bank embarked on a complete reorganisation in which it reversed every policy. It increased its loan rates by half and shifted its target client group from the well-connected to poor people without any ties to government or financial companies. It actively marketed deposits and abolished minimum limits on account. Success followed rapidly. The BRI formula has since been emulated around the world.

In some ways, a successful financial institution may find it tougher to move into microfinance than an ailing one. Bank Pichincha, the leading bank in Ecuador, has created an entirely separate subsidiary, CREDIFE, to serve poorer customers. Its results have been remarkable: small loans now make up 5% of its assets but 8% of its profits. Unibanco in Brazil and Banco Santander Chile took similar steps to attract the unbanked poor. Such efforts are not always welcomed by existing microfinance providers. In Colombia, for instance, Women's World Banking complains that mainstream banks are increasingly poaching its best clients.

The power of a balance sheet

After just two years in the field, ICICI, India's second-largest private bank, now has close to 1.5m customers that qualify as deeply poor, and an associated loan portfolio of $265m. It has achieved this by working through 53 small microfinance banks, which are superb at marketing loans but are constrained by having them sitting on their balance sheet. ICICI lends to the microfinance institutions at 9.5-11%, a bit more than it charges its corporate clients, and the microfinance institutions re-lend the money at 16-30%. The microfinance providers are responsible for the first 5-12% in loan losses to ensure that they proceed with caution. Returns are good and ICICI wants to expand the scheme.

The seeds of a better life

There are ample opportunities. According to some estimates, demand for loans from poor but creditworthy people in India could amount to $40 billion, 40 times the current supply. Nachiket Mor, an executive director at ICICI, says very little of the demand could be met from charitable sources, but billions of dollars could be made available on commercial terms. Lots more could be raised by allowing small institutions to take deposits.

Many of the world's biggest banks have recently launched interesting pilot projects. ABN Amro owns a microfinance bank in Brazil, Real Microcrédito, jointly with ACCION, and provides credit to five microfinance institutions in India. Deutsche Bank recently raised a $75m investment fund and syndicated a large loan on behalf of ProCredit in Germany.

The most obvious way for large banks to get into microfinance is through handling remittances, a business that according to the World Bank is worth $225 billion a year and growing strongly. Until now it has been dominated by transfer agents such as Western Union and by informal arrangements, often with high charges or high risks. But money transmission is becoming more competitive, and global banks are well placed because they already have systems that can send large amounts of money around the world cheaply.

In September, Bank of America announced that all its account holders would be able to send remittances to Mexico without charge; the money can be retrieved at other banks and payment agencies. HSBC in May announced a joint-venture with Opportunity International that allows money to be sent to the Philippines via the internet and retrieved from local ATMs. In America, HSBC has just launched a scheme under which anyone with a minimum account balance of $1,500, or willing to pay $8 a month, can transmit money to HSBC's affiliates abroad without charge. To start with, this may not be profitable for the bank, but HSBC reckons that much of the money could be channelled into savings accounts from which other services might follow.

The most ambitious big bank in this area is Citigroup. It does not deal with individual microfinance customers, but has already established relationships with microfinance institutions in 20 countries and thinks the number could soon grow to 30. Working through its Banamex subsidiary in Mexico, it is providing life-insurance policies sold by microfinance firms and is preparing for various bond offerings, private placements and even the securitisation of a large microfinance institution's loan portfolio that will be resold to investors. For its wealthy clients, it has created guarantee funds that allow them to put up collateral in America for credit extended in poor countries. The list goes on.

Citi's biggest contribution, though, is its belief that microfinance can become a valid, profit-making business. If it is right, the other big banks will also pile into the market—and so will investors.

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Critical acceptance

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The emergence of rating agencies attests to the industry's growing maturity

WHEN representatives in Kenya of three of the world's largest banks were asked what single event would most encourage their institutions to become more involved with microfinance, they all came up with the same answer: the presence of credit-rating agencies.

Businesses love to complain about these agencies, and financial institutions grumble more than anyone else. It is rare for companies to get the ratings they believe they deserve. But nor are the users of ratings all that happy, because the agencies are generally not very good at predicting default rates. Banks tend to see the agencies as a form of competition, providing information that outside investors use to purchase debt, to the detriment of the banks' own lending business.

Nevertheless, rating agencies provide a relatively objective and consistent credit benchmark that is a great help to big investors. Banks, despite their carping, rely on these outside ratings for developing their own internal credit models, even if their in-house evaluations come out a little different from those of the rating agencies. Without such models, tracking loans, assigning risk capital and managing cash would take up far too much management time.

Being relatively small, most microfinance institutions are reluctant, or perhaps unable, to pay much for a rating. The big agencies—Moody's, Standard & Poor's and Fitch—have so far rated only a few institutions, notably ProCredit of Germany, Compartamos of Mexico, Mibanco of Peru and Acleda of Cambodia. That leaves thousands unexamined.

Several specialist credit-rating agencies have recently stepped into this vacuum. However, they face huge barriers to establishing credibility in the marketplace, because ratings need to prove themselves over a period of time. Meanwhile some have launched other businesses on the side, but these can undermine their perceived objectivity.

MicroRate, the oldest specialist rating agency and the only one that sticks purely to this particular business, was founded in 1996 but did not reach break-even point until this year. It was fired by three institutions for being too hard on them, but that may have been no bad thing for its reputation. Demand from investors has steadily grown, and it now rates 45 microfinance organisations.

Many of those brave enough to have asked MicroRate to run a rule over them have received poor grades for having “financial, operational or strategic weaknesses that have the potential to threaten their viability”. This can mean anything from inexperienced managers and boards to a lack of internal controls, too much reliance on a single person (often a charismatic founder) or an inability to raise funds for growth. So why do such companies bother to get rated? They must believe that things can only get better.

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Bankable banks

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Are the poor a good investment?

A credit to her business

THE enthusiasm for microfinance rests on the idea that people who have next to no money deserve financial services just as much as those who have plenty. This is often justified by notions of equity or fairness: everyone should have clean water and health care, and everyone should have the right to deploy their talent. But on that view microfinance becomes yet another public good, limiting its scope to whatever can be squeezed from philanthropists or governments.

A more optimistic justification is that microfinance can support equity in the strictly financial sense, meaning it can produce profits. If so, it will be able to attract all the investment the rich world can provide to fund all the opportunities poor people can handle.

The evidence cited by the optimists typically comes down to a single fact: that microfinance clients repay their loans. Undoubtedly many of them do, but whether the aggregate numbers hold water is less certain. Industry-wide data are in short supply, and those that are available suffer from what statisticians call “survivorship bias”: institutions with terrible repayment records go bust, taking their bad numbers with them and leaving only the better records to be examined.

Worse, there are widespread suspicions that some microfinance banks hide poor repayment rates by rolling over bad loans or extending their due dates indefinitely, which they can keep up as long as there is an inflow of donor funds. Even when repayment rates are high, a microfinance institution may charge an interest rate too low to cover its overall costs or its costs of funds, thus making it more of a charity than a commercial enterprise. Successful microfinance banks often charge vertiginous interest rates, because that is what poor people must pay to be commercially viable customers.

A good test of whether microfinance customers are truly bankable is whether the microfinance banks are bankable themselves, in the pithy words of Peter Kooi, head of the United Nations capital-development fund's microfinance unit. In other words, are those banks worth investing in? So far, this test has rarely been applied. No microfinance institution has traded seriously on a public stock exchange. Only one, BRI of Indonesia, has a genuine public listing, and that has been going for less than two years, not enough to judge its quality. A handful of others, including Mibanco of Peru, Banco Solidario in Ecuador and Satin in India, are listed but rarely trade.

Until recently, when a flurry of microfinance investment funds were launched, most of the money backing microfinance institutions came from the least demanding sources of capital: governments, multilateral institutions, not-for-profit organisations and “socially responsible” private investors

who either did not demand market rates of return or valued their returns in unorthodox ways.

There has, however, been one notable exception. In 1995, a handful of social investors, headed by ACCION International, Calmeadow of Canada, Triodos of the Netherlands and Fundes of Switzerland, raised $23m to create Profund, a Latin American investment pool intended to demonstrate that investing in microfinance could be commercially viable. It was designed to run for ten years, and true to its mission it sold off its last investment this summer. By liquidating its portfolio and turning it into real cash, it became a yardstick for the investment performance of a microfinance institution.

At first sight, its returns look unexciting: just 6% annually, despite lots of risk. But on closer examination this was a remarkable performance. All of Profund's capital was contributed in dollars and then invested in local currency. In every country it operated in, its dollar returns were reduced by local currency depreciations, reflecting the economic chaos in much of Latin America during that decade. Two of the countries in which it had investments, Paraguay and Ecuador, suffered system-wide financial collapse. Haiti, Venezuela and Bolivia faced riots and revolutions. Good banking is, in the end, no match for bad government. Most investors in the region watched their money burn.

Initially, Profund had expected to be a passive investor. It bought stakes in a dozen institutions, hoping simply to hold on and then sell out. But Profund's manager, Alex Silva, soon found himself attending monthly meetings of the institutions he had invested in and getting involved in managing them.

Mr Silva, with ACCION and a German consulting firm, IPC, played a crucial role in helping the institutions that Profund invested in to evolve from not-for-profit NGOs into regulated banks, able to receive deposits. During Ecuador's financial crises of 1998, when all private debt repayment was suspended by the government, Mr Silva helped to arrange a crucial $5m emergency loan to keep one local microfinance provider afloat. The loan, at an interest rate of 15%, was fully repaid within 18 months. Without it, this well-managed bank would probably have died, taking Profund's $2m investment with it.

Where's the exit?

Getting out of investments proved equally complex. Unlike in developed countries, there were no local stockmarkets eager for new listings, nor hungry groups of local investors. Profund had to work hard on each exit deal, often under pressure from larger shareholders hoping to orchestrate a squeeze. In the end, three of Profund's investments did blow up. But the fund's investment in Compartamos of Mexico performed spectacularly, and investments in Mibanco of Peru, BancoSol of Bolivia and Los Andes of Peru also did well. Several other investments failed to produce respectable returns only because of currency depreciations.

All this looked very much like the distribution of returns typical in venture capital—plenty of duds, a few stellar performers—rather than in mainstream banking. The fund's success owed at least as much to the efforts of Mr Silva and his investors than to the underlying economics of the industry. One lesson from Profund's experience is that interest rates in this business have to be pitched high to make the loans viable. Compartamos charged more than 100% annually when the initial investment was made, and Mibanco over 80%, though both of them have since dropped their rates somewhat. Initially, potential clients are less concerned about cost than access to money. Besides, even high interest rates charged by microfinance institutions are probably well below those being offered by moneylenders in the informal market.

Profund's investors were sufficiently impressed by its success to want to see its charter renewed,

but Mr Silva has declined to do so. Unlike in 1995, there is now abundant capital available for investment in microfinance—perhaps too much, he says, at least for Latin America to absorb.

In the past three years, new investment opportunities in microfinance have been popping up all the time, and more are on the way. In the largest example yet, Pierre and Pam Omidyar, flush with money made from eBay, have pledged $100m to back microfinance projects, a source that is as yet almost entirely untapped. It will not stay that way for long.

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Micro no more

Nov 3rd 2005
From The Economist print edition

Financial services for the poor and the rich are becoming increasingly alike

Hewlett-Packard's Ugandan bank-in-a-box

THE group of 30 women in the dusty square of a poor village outside Hyderabad, their children on their laps, passing tiny deposits and loan payments to a young man in their midst, seem to be engaging in a form of finance quite unlike that practised in the City of London or Wall Street. But is it really that different?

Microfinance offers all the transactions you would expect in any branch of finance: loans, deposits, money transfers, insurance. It is distinct only because it involves amounts of money so small that in the past conventional firms did not think them worthwhile. That is clearly changing.

Many microfinance institutions report better returns on equity than do large banks. Five years ago, providing financial services to people with little money might have been dismissed as a tiny niche business or charity. Now all the participants in the capital markets, from big banks to investors to rating agencies, are beginning to open up to it.

The evolution of microfinance into a serious and viable business has many benefits. It means that in future the bulk of the capital is likely to go to the most efficient institutions with the best growth prospects. They will select their clients on the basis of merit rather than cronyism or bribery, of which state banks (as well as some private banks) in poor countries have often been guilty in the past.

Sound institutions will be able to protect their deposits and attract new ones. In the most

optimistic scenario, an open, viable financial sector will create a large body of people with economic stakes in their society who will demand decent public services, which in turn should help to promote growth.

Plenty of obstacles remain. Venezuela, Brazil and Colombia, for example, all impose interest-rate ceilings, and other countries are considering them. These discourage new financial firms from entering the microfinance market and encourage existing participants to evade regulation.

But within a few years, the number of people who have access to financial services may expand from hundreds of millions to several billions. Historical precedent suggests that this could bring huge opportunities. In the past, some financial institutions, notably Bank of America, Merrill Lynch and many large European insurers, did spectacularly well by nurturing clients only slightly too poor to be of interest to the leading firms of the day.

But to reach the vast number of people who currently lack access to the financial markets, microfinance will have to change. Four main areas need particular attention: culture, products, funding and the cost of operations.

The cultural challenge is to transform something that started as charity into a proper business. The pursuit of profit may not come easily, but change is already in the air. “We are not paternalistic, we do not lend to the poor,” says Mónica Hernández of Banco Solidario, a fast-growing and profitable bank in Ecuador. “We lend to those who do not have access.”

To reach this new group of customers, however, microfinance providers will have to abandon their old attitudes and vocabulary and join the mainstream of the global financial system. Transmitting funds, insuring risks, extending credit and holding deposits for people with almost no money will turn out to be little different from doing those things for anyone else.

Beyond credit

One priority is to expand microfinance beyond credit into all the financial products on offer in more sophisticated markets. Today only a few institutions are seriously offering insurance, even though it is particularly valuable to the poor; yet death and illness, for example, are major risks for banks making small loans, and inevitably they charge for bearing that risk. BASIX, a dynamic microfinance institution in India, provides not only basic life insurance, but other products that are particularly appropriate to its agricultural clients, notably insurance against drought or loss of cattle.

It matters enormously where the money comes from. At present, the main sources are charities, governments and international organisations. But serious interest from large banks and private investors would greatly increase the amount of capital available and bring down the cost of funds. The emergence of credit-rating agencies to provide an independent assessment of institutions will make it easier for the banks to come in. Credit bureaus for rating individuals too are now being established in a handful of countries.

Microfinance institutions may also tap wealthy investors directly. More than a dozen institutions recently raised money from American investors, including a university, in a deal structured by Developing World Markets, a specialised American firm of financial advisers, and Blue Orchard Finance of Geneva, a microfinance fund manager. True syndication of microcredit loan portfolios may not be far away, though governments in many poor countries will have to strengthen ownership rights and reduce barriers to foreign investment before it becomes commonplace.

Crucially, the cost of microfinance will have to come down. At present it is far too manpower-intensive, more like private banking for the wealthy than retail banking for the middle classes. Typically, borrowers receive visits from their bankers, sometimes daily, rather than going to a branch or using an automated teller machine. Credit evaluation relies on character or cashflow valuation rather than the statistical techniques used by credit-card companies in rich countries. This has been made possible by low wages and an abundance of highly talented people willing to work long hours, but it will not be sustainable.

More competition will help to reduce costs, but the biggest hope comes from new technology. For example, the cost of sending money from Hong Kong to the Philippines has declined dramatically because of new methods that transfer funds via mobile phones, says John Owens, of Chemonix International, a consultancy. And that is only one of their uses. Through arrangements with merchants in small towns, mobile phones can also be used to pay loans, make deposits and get cash, saving time and money. Vodafone is testing a similar system in Kenya, and Hewlett-Packard has just finished a pilot project in Uganda using a point-of-sale machine with mobile-phone technology. Such techniques may eventually make branches, cheques and even cash superfluous.

In the past, the two main obstacles to providing financial services to poor people have been lack of information and costs. Those obstacles are now being overcome. Ultimately lower costs and better information are good not just for the poor, but for everyone. Microfinance may have started as a niche business, but the chances are it will soon be micro no more.

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Leading academic papers on microfinance and links to key microfinance organisations can be found at www.microfinance.com.

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European telecoms

Survival of the biggest

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Telefónica's bid for Britain's O2 would create the largest phone company in the western world. That does not mean it is a good idea

THERE used to be a gentlemen's agreement between Europe's incumbent telecoms operators that they would not invade each other's home territory. But the old non-aggression pact has been eroding for some time. On October 31st it finally collapsed when Spain's Telefónica made a £17.7 billion ($31.5 billion) all-cash offer for O2, one of the largest mobile-phone operators in both Britain and Germany. O2 is recommending the offer.

A union between Telefónica and O2 would create the world's second-largest phone company by number of customers (after China Mobile), with 170m mobile and fixed-line users in Europe and Latin America. On one level, the bid is a sign of the boisterous confidence of the Spanish operator. But it is also a symptom of the fact that European telecoms companies know that they are operating in a new and tougher environment, in which sitting comfortably in your home market is no longer really an option. The combination of the after-effects of the technology bubble of 2000, the cost of third-generation wireless licences and the rapid entrance of new rivals and technologies means that companies now need to look further afield to grow—and even to survive.

A different sort of symptom of this new era for telecoms came on November 2nd when Deutsche Telekom announced that it plans to lay off 32,000 workers out of its total work force of 244,000. Kai Uwe-Ricke, the company's chief executive, said the job cuts were a necessary reaction to “the worldwide realignment of the industry, the rapid pace of technological development and...the tough competitive environment.” Retrenchment on one front is likely to be accompanied by expansion elsewhere. However, Deutsche Telekom's T-Mobile, which tried to buy O2 earlier this

year, said it did not intend to make a rival bid to Telefónica's.

The big European telecoms firms are jostling each other for fear of coming off worst in a continent-wide wave of consolidation. Telefónica's bid for O2 is itself partly a reaction to the fact that its own home turf was invaded by France Télécom in July, when the French firm bought an 80% stake in Amena, Spain's second-largest mobile company. As the last major independent wireless firm in Europe, O2 is also attractive to suitors who simply want to prevent rivals from acquiring it first. The O2 deal would then set the stage for even more consolidation.

If the Telefónica-O2 deal goes through, it will sharpen competition in the mobile market. But it will also eventually threaten the incumbent fixed-line carriers, such as Britain's BT and Deutsche Telekom. This is because while entry into the market is via mobile phones, it comes at a time when wireless technology is increasingly a substitute for both traditional copper-wire phone calls, and soon, broadband internet access. Among major mobile operators, only Vodafone remains true to a pure wireless strategy worldwide—other wireless firms are mainly old telecoms incumbents attempting to salvage their business through diversification.

Telefónica's chairman, César Alierta, justified the proposed acquisition as a way of broadening the firm's reach across different markets and technologies. Today, the majority of Telefónica's sales come from Spain and Latin America, as well as from traditional fixed-line calls. With O2, the percentage of revenue from elsewhere in Europe will increase from 5% to 21%, and the proportion of fixed-line revenue will decrease by ten percentage points, in favour of wireless.

Yet in some ways the deal represents a step back in time, not forward. Only five years ago, the fashion was for incumbent operators to spin off their wireless and internet divisions. Now telecoms carriers are putting these assets back together again. The idea is that customers will want a seamless service. But inevitably, as the wave of consolidation and counter-consolidation gets going, mistakes will be made. Moving into new (and mature) markets by paying a huge premium for a mobile operator may not make good business sense, since the price of mobile calls is falling and there is no certainty that new mobile services will fill the revenue gap.

Investors have given the Telefónica bid a lukewarm reception. The deal is expensive: a 25% premium over the company's average share price in October. And it appears to offer few obvious synergies or opportunities to cut costs or increase revenues. Nevertheless, there are likely to be more mergers in the coming months. Telefónica, Deutsche Telekom and France Télécom are expected to be the main consolidators. Private-equity firms would also like to be buyers, although they might be constrained by financial considerations from bidding as much as the telecoms giants which can cite long-term strategic necessity. Norway's Telenor, Portugal Telecom and Bouygues, a French mobile telecoms firm, are thought to be among the juiciest potential acquisition targets.

Europe is not the only place where big telecoms mergers are underway. This week, America's Federal Communications Commission (FCC) finally gave formal approval to the acquisitions earlier this year by Verizon of MCI (the formerly bankrupt WorldCom), and SBC of AT&T (with the groom taking on the bride's better-recognised brand-name). In contrast with the recent telecoms consolidation in America—which has reduced the number of telecoms operators—so far the takeover wave in Europe has not led to fewer operators, since it has largely been driven by companies in one market moving into another.

In America, consumer-advocacy groups complained that the mergers would decrease competition and successfully persuaded the FCC to impose conditions. It required the firms involved to sell broadband without forcing customers to pay for a separate voice line—thus boosting the prospects for internet telephony. And it forbade the firms from discriminating against the source of internet traffic that flows across their networks—to prevent them from blocking internet phone calls and soon TV, in order to sell these services themselves. As they seek to follow suit, European firms

(and regulators) should take note.

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Motorola

Pretty in pink

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What the success of the RAZR says about Motorola's fortunes

RAZORS can be dangerous, even deadly. But Motorola's sleek, sexy RAZR V3 mobile phone has given the company's health a much needed boost. The world's second largest handset-maker has just announced bumper results, thanks in large part to the success of the RAZR, which is currently the bestselling mobile phone in America. Motorola sold a record 38.7m handsets worldwide in the third quarter of this year, lifting its market share to 19%. One in six of those was a RAZR, which is available in silver and black and, from this week, in pink too (a colour previously available only to celebrities such as Maria Sharapova, a tennis star). With its close resemblance to a flip-open “Star Trek” communicator, the RAZR is on its way to becoming an iconic gadget, next to the iPod and the BlackBerry. It is great news for Motorola, which was going through a difficult patch until the arrival of its new boss, Ed Zander, last year.

By revitalising the company's employees, drawing in new customers and boosting Motorola's brand, “the RAZR is a demonstration of what this company can do,” says Richard Nottenburg, Motorola's chief of strategy. And by highlighting how Mr Zander has turned around Motorola's reputation for clunky design and slow, spotty execution, the RAZR “has been a symbol of all the things we have done right in the past 18 months”. Although the RAZR was in development before Mr Zander arrived, says Mr Nottenburg, he “got this party started” by championing the product.

But you can also make the case that Motorola's revival does not extend much beyond the RAZR. Motorola's other phones still look clunky in comparison. Its much-hyped ROKR music phone, made in conjunction with Apple, is regarded as a disappointment. And having been an early leader in “third generation” (3G) phones, Motorola has since fallen behind. Even the RAZR itself, once you open its slimline case, is let down by its cheesy menu system and second-rate camera. Meanwhile, two rival handset-makers, Samsung and LG of South Korea, have each cooked up their own RAZR-like handsets. The sincerest form of flattery, says Mr Nottenburg. But the risk, says Carolina Milanesi of Gartner, a consultancy, is that “when everyone starts to do it, you lose the edge.”

The big question, then, is whether Motorola can follow up on the success of the RAZR. Mr Zander's plan is simple: “more RAZR”. A 3G version is on the way, along with two new phones, the slimline SLVR and the curvy PEBL. The RAZR Q, a BlackBerry-like device with a keyboard, is due next year. “We have a very good product pipeline,” says Mr Nottenburg. But Ms Milanesi is unconvinced. Motorola still has quality and execution problems to sort out, and the PEBL, announced in February, already looks dated, she says. So whether the RAZR is a symbol of Motorola's resurgence or a one-off hit remains to be seen.

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Economist.com BUSINESS

Fraport

Expansive gesture

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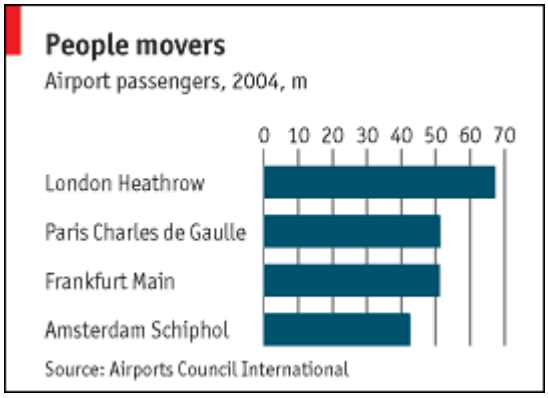
Germany's leading airport operator is hell-bent on growth

A FEW inhabitants of Offenbach, under the Frankfurt airport flight path, vainly tried to stop the course of history on October 29th. That was when the A380, the giant passenger jet developed by Airbus, made its first landing at Frankfurt to test the facilities there. Among other things the double-decker plane, designed to carry 555 passengers, needs disembarking tubes that reach both decks. Frankfurt, which is competing with London and Paris to be Europe's aviation hub, has built them already, although the plane will not come into service until 2007.



That says something about the commitment of Fraport AG, which operates the airport, to continued expansion despite some hefty local opposition. Fraport plans to increase the airport's capacity from 50m passengers a year to 80m by 2015. That involves building a third terminal, a giant maintenance hangar for the new Airbus, and a fourth runway to the north-west. Only the hangar has so far been approved.

Heathrow, which currently serves about 68m passengers a year but is anxious about the challenge it faces from Frankfurt, faces similar tasks. The British Airport Authority (BAA) says that London's leading airport must build a third runway. But because jobs are plentiful in the south-east of England, BAA may have a tougher time overcoming local opposition than its German competitor. Fraport is playing a strong hand in a country that is obsessed by the need to dent a national unemployment rate that is now running at nearly 12%. The company has 13,000 people on its payroll, among the 65,000 who work at the airport. Many international firms locate near Frankfurt simply because of the airport. Fraport claims the airport's expansion will stimulate the creation of 100,000 new jobs.

But Germany's Greens are still a powerful force. Fraport has committed itself to a ban on night flights when the new runway is built—unlike BAA. The expansion of Frankfurt airport will also eat into 21 hectares of woodland, the home of various bats and a rare species of stag beetle. But the biggest obstacle to the new runway is the existence of a large chemicals plant to the west of the airport. Planes already fly over the plant on about 90 days a year when the wind blows from the east. Using the new runway the planes will fly over the plant lower and more frequently. Fraport's own studies suggest a minimal increase in the risk of a double catastrophe. A study by the federal disaster commission, however, is not so sanguine. The building of the new runway has already been postponed from 2007 to 2009 and could be postponed again.

The airport operator, which is listed on the Frankfurt stock exchange, is not putting all its eggs in its home basket. It has a joint-venture in Shanghai. It is bidding to operate one of India's two main airports at Delhi and Mumbai. It already has investments or operating contracts in Lima,

Cairo, Antalya and Vienna. And it is on the shortlist of bidders, together with BAA and three others, to buy 75% of Budapest airport. Wilhelm Bender, its chief executive, argues that Fraport is unique because it covers all aspects of the airport business, from handling flights and ground operations to security and shopping. It can sell that expertise as a package to other centres. It also has a foothold in the low-cost airline business as the 65% owner and operator of Hahn, a former military airfield 110 kilometres from Frankfurt that is used by Ryanair and others. (Low-cost airlines avoid Frankfurt airport because of its long turnaround time.)

Fraport estimates a 5% annual growth in passenger numbers and a 6% growth in freight at Frankfurt for the foreseeable future. There is still heavy demand for landing slots. The question is how far politics and public opinion will continue to support expansion. Friedrich von Metzler, a banker whose luxurious Frankfurt villa lies right under the flightpath, is prepared to make the sacrifice. “Without the airport I couldn't keep the villa,” he says.

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Standards wars

Singin' the Blus

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Sony's high-capacity DVD technology is likely to trump Toshiba's

AFP

THE battle over which technology will be used for a new era of information-rich DVDs is starting to lean heavily in favour of Sony's Blu-ray standard. This is bad news for Toshiba, which champions an alternative, also based on blue-laser technology, called HD-DVD. In recent weeks two big Hollywood studios, Warner Brothers and Paramount, that had previously plumped exclusively for HD-DVD have agreed to support Blu-ray as well—citing Blu-ray's wide support and strong copyright-protection mechanisms. That leaves only Universal Studios solely committed to HD-DVD, and even it is expected to adopt Blu-ray in addition. But several other studios including Columbia Tristar and MGM (both owned by Sony) and Disney have committed exclusively to Blu-ray.

If Sony does win out over Toshiba, it will be sweet revenge for its defeat in previous standards wars. In 1995 the current format for DVDs was based more on Toshiba's technology, rather than a rival format devised by Sony. Even earlier, Sony's Betamax video technology lost out to the more open VHS system. The Betamax-VHS war taught a generation of executives about the importance of building industry-wide support for a new technology. That is why the fact that a majority of Hollywood studios have now adopted Blu-ray is such good news for Sony. In both previous standards wars, the allegiance of the studios proved decisive.

Both Blu-ray and HD-DVD hold so much more data than today's DVDs that they can carry an entire season's worth of sitcoms, or splash high-definition films across a huge screen. However, they are incompatible because they are physically different. So it is costly for content suppliers and DVD-makers to adopt both technologies. HD-DVD is less expensive to manufacture because firms can simply upgrade existing production lines. But Blu-ray has an advantage because it will get into customers' hands by virtue of its inclusion in Sony's PlayStation 3 video-game console and in PCs, while HD-DVD technology will often require customers to buy a stand-alone HD-DVD

player.

Whoever wins the standards war will profit handsomely from the royalties for the technology. Around 70 companies have contributed intellectual property to Blu-ray, and slightly fewer to HD-DVD. The licensing fee to use either standard is not set, but it is expected to be a bit more than the current $12 for a DVD player, $5 for a PC drive, and around 15 cents for a disc.

Sony's Blu-ray counts Apple, Dell, Hewlett-Packard and Philips among its backers. Toshiba's HD-DVD is supported by Microsoft and Intel. This is partly because it incorporates Microsoft technology called iHD for interactive services, and a feature called “managed copy” that lets users copy films on to PCs and other devices, which Blu-ray (being more sensitive to the copyright interests of the studios) does not allow. In October, Hewlett-Packard proposed that Blu-ray adopt both features. Meanwhile, China has proposed its own standard for high-capacity DVDs, to avoid paying royalties to foreign firms.

If HD-DVD does not admit defeat and the standards war remains unresolved, it will delay the adoption of a new DVD format by two years as consumers balk before buying, predicts Ted Schadler of Forrester, a market-research firm which has just issued a report predicting that Blu-ray will ultimately win the battle. Strangely, the war comes at a time when the very notion of having a physical product to hawk intangible media threatens to become anachronistic. In future, consumers will increasingly get content over networks, not on shiny disks.

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Economist.com BUSINESS

Alternative energy

Another false dawn?

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High oil prices are spurring investments in alternative fuels

"OIL and natural gas availability has been severely impaired and the effects of this will reverberate through the economy of this country for some time." Those chilling words were uttered recently by Samuel Bodman, America's energy secretary, as he pleaded for his country's gas guzzlers to start conserving energy. He warned that high prices could be here for years. Greens are ecstatic. They think high oil prices may spur a sustainable clean-energy boom. GE's wind-turbine business, which was inconsequential a few years ago, made over $2 billion in sales this year. Ethanol, a costly green fuel which in America is usually made from corn, now looks a better buy. And wind and solar power are also back in fashion.

Industry sources reckon that global sales of solar panels this year will reach $11 billion, up from $7 billion last year. America's Energy Conversion Devices, a pioneer in hydrogen storage and solar cells, has seen its shares soar by 50% this year and venture-capitalists are taking an increasing interest in the industry. Sun Edison, an American start-up, has persuaded Goldman Sachs to fund up to $60m of its solar projects, which BP's solar manufacturing division has agreed to provide. Sun Edison offers retailers fixed-price electricity contracts if they allow it to set up solar panels on their rooftops. At a time of ever-rising oil and gas prices, that kind of deal has its attractions—Whole Foods and Staples have already signed up.

All told, reckons Christopher Flavin of the Worldwatch Institute, a green think-tank, investments in "new renewables" (not including big dams, which nobody likes anymore) grew from $24 billion globally in 2003 to $29 billion in 2004—and, he thinks, the pace of growth is even faster this year. Mr Flavin says he is "blown away" by the development of the renewables industry.

Such jubilation is understandable, but it may be slightly premature. For one thing, clean energy is not the only sort of "alternative" energy that is enjoying a boom: dirty technologies like Canada's mucky tar sands (from which petrol can be made at great environmental expense) are also benefiting from high oil prices. In theory, there is as much energy trapped in Alberta as in all of Saudi Arabia. In practice, it has proved too complex and expensive to be a serious rival to oil—until now.

Today's oil prices, combined with cost reductions and innovations in tar-sands processing, are leading to a bonanza. Peter Tertzakian of ARC Financial, a Canadian investment firm, estimates that investment in tar sands will leap to C$7 billion ($5.95 billion) this year, up from C$4.2 billion in 2000. More impressive is the tidal wave to come. High oil prices have prompted a flurry of investment in new projects and expansion efforts in tar sands that will, he estimates, add up to a whopping C$70 billion in coming years.

To the chagrin of greens, today's high prices are giving even filthy coal, their *bête noire,* a new lease on life. Several American utilities are now talking of building new coal plants, partly to hedge against natural gas price risk. More striking is a coal deal recently announced by the state of Pennsylvania and a consortium which includes the oil giant Royal Dutch Shell. Using an innovative

process (developed by South Africa's Sasol), the consortium will convert coal waste into a liquid that can be blended into normal diesel fuel.

The rise of coal and shale shows that the surge in oil prices is not an unambiguous win for the greens. And green investors might be unwise to rely on permanently high oil prices. The vast reserves of oil remaining in the Persian Gulf suggests prices will eventually moderate. And as the earlier failed renewables booms of the 1970s and 1980s showed, oil price drops can wipe out alternative energy. Technological breakthroughs and green policies like carbon taxes suggest that this renewable boom may be more sustainable than the last one. But investors counting on sustained high oil prices to justify otherwise uneconomic projects should beware.

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Corporate crime

A crackdown too far

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A 24-year jail sentence is thrown out

IN MARCH 2004, Jamie Olis, a former tax-planning executive at Dynegy, was sentenced to 24 years in jail, with no prospect of parole, for his role in Project Alpha, an accounting fraud that inflated the Texan energy company's cashflow by $300m. On October 31st, an appeals court, though upholding the conviction, threw out the sentence, concluding that Sim Lake, a Houston judge, had greatly overstated the losses caused by Mr Olis.

Mr Olis, who had no criminal record, has been a cause célèbre of those who worry that America's recent crackdown on errant executives has gone too far. His 24 years have been exceeded (so far) only by the 25-year jail term handed to Bernie Ebbers, the former boss of WorldCom. Mr Olis's fate has also been seen as an object lesson of the dangers in the current climate of pleading not guilty and going to court, rather than striking a plea bargain with prosecutors. Mr Olis's boss, Gene Foster, and a colleague agreed to plead guilty in exchange for at most five-year sentences. Mr Foster then testified against Mr Olis in court.

Judge Lake had based the sentence on the $105m loss to a big shareholder, the University of California Retirement System (UCRS), that he said was due to Dynegy restating its results to correct its dodgy accounting. Under a controversial points system used in mandatory federal sentencing guidelines, this loss translated into a jail term of between 292 and 365 months.

These guidelines were thrown out by the Supreme Court in January. But according to this week's ruling, even under the guidelines Mr Olis got the wrong sentence, as he was not responsible for most of the loss. Among other things, the court's loss calculation had ignored the fact that UCRS bought its shares at the top of the market, that both the overall market and shares of similar firms had since fallen, that Dynegy's share price may have been hit by its failure to acquire its faltering and allegedly fraudulent rival, Enron, and that over two-thirds of the loss occurred either before the accounting restatement or more than a week after it. The appeals court suggests that at least $100m of UCRS's loss cannot be attributed to Mr Olis.

Judge Lake must now decide how long a sentence is reasonable. There is a case to be made that it should be limited to time already served, though some experts think that Mr Olis's crime justifies a few more years in jail. These are busy times for Judge Lake, who is also due to preside over the forthcoming trial of Enron's former top executives, Kenneth Lay, Jeffrey Skilling and Rick Causey.

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Chinese companies

Over the Great Wall

Nov 3rd 2005 | HONG KONG
From The Economist print edition

China is allowing more foreigners to control its companies. But it is imposing too many conditions

Get article background

THE barbarians are hurdling the Wall. On October 25th Carlyle, a private-equity firm, became the first foreign buyout group to gain control of a big Chinese company. In one of the biggest private-equity investments yet in China, the Americans paid $375m for 85% of Xugong, the country's leading maker of construction machinery. Carlyle will nominate six of the nine board directors, says X.D. Yang, co-head of its Asia buyout group.

The deal is being hailed as another step forward in the mainland's march towards western capitalism. Some observers scent a change in official policy. In recent days China's Railway Ministry has said that it is ready to let foreigners take full ownership of its local railways. Last month UBS, a Swiss bank, gained a 20% holding and management control of Beijing Securities, the first time a foreign investor has been granted a direct stake in a licensed domestic broker. Late last year, Goldman Sachs was allowed to set up a domestic investment bank, over which it claims future control rights. Meanwhile there are rumours that foreign beer firms including Anheuser-Busch and Heineken are discussing taking a controlling stake in China's eighth biggest beermaker, Fujian Sedrin Brewery.

All this looks like evidence that Beijing is willing to relinquish control over state companies. Fang Fang, a managing director at J.P. Morgan, the bank that advised on the Xugong sale, calls the deal: “a change in thinking. It signals that the regulatory and legal and capital markets frameworks in China have come of age.”

If true, this would be good news. Government ownership is bad for companies everywhere and especially in China. Despite years of restructuring, China's state-owned firms remain poorly profitable and under-capitalised. Even in private firms, meddling by local and provincial governments have ruined many a well-run company. Kelon, a once high-flying maker of fridges, is now close to collapse after excessive state interference. Having a government owner can also kill the overseas expansion plans of even the most modern Chinese company. Fu Chengyu, head of CNOOC, an oil company, recently said he would consider asking the government to cut its 70% stake in his firm. This summer, Mr Fu was forced to withdraw an $18.5 billion bid for Unocal, an American rival, following furious resistance by American politicians who objected to a Chinese state-owned firm owning strategic American assets.

Yet the Xugong deal is not quite the change of heart by China's leadership that observers think. Construction machinery is not regarded as a sensitive sector, which eased Xugong's sale. Critical industries from energy to defence and especially China's banks, which desperately need foreign owners, will probably remain under state control. The banking regulator this week confirmed reports that the investment arm of China's central bank, Central Huijin Investment, which is the biggest shareholder in Bank of China, has voted to block a long-mooted plan by Singapore's

Temasek to take a 10% stake in the lender. Moreover, the Xugong deal was not hatched in Beijing; rather it was the initiative of the Xuzhou city government in liberal Jiangsu province, where the company is based. Even so, getting Beijing onside took two years.

Gaining control also comes at a price for foreigners. Carlyle had to pay almost twice book value compared with the 30% premium of previous Chinese private-equity deals. It also had to agree to take on Xugong's 43% share of a listed roadbuilding subsidiary that has just posted big losses. Moreover, because the city government still owns 15%, Carlyle cannot gear up Xugong with debt as in a conventional leveraged buyout, potentially reducing its returns. Such complications could reduce the pool of potential foreign buyers.

Critically, China is not giving foreigners a free hand to manage their investments. With half the mainland market for mobile cranes and booming construction demand, Xugong already makes decent profits. Its chairman Wang Min insists the management team will stay in place, as will the name—a condition to which Carlyle had to agree. The real reason the Americans have been invited aboard is to build Xugong into an “international brand” and give it access to new technology.

Carlyle clearly think it can achieve this goal and make money. But the Chinese government's obsession with creating hi-tech national champions risks undermining the very thing that has given Chinese companies an edge—low costs and prices. Kelon was ruined after its state managers forced costly technology on it when its real advantage had been stylish, but simple and cheap fridges. Xugong faces similar risks. Its success so far has come through selling decent machines at one-third of the price of foreign rivals. Yet Carlyle has been told to introduce Xugong to technology firms to help it compete with foreign rivals like Caterpillar overseas.

Rather than being free to clean up Xugong and sell on a focused and efficient machinery-maker, Carlyle is being pushed by the government into the latest quest to create a global champion. China may really reap the benefits of foreign ownership only when the government drops the belief that it knows best and stops imposing conditions on foreign buyers.

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Economist.com BUSINESS

Face value

The evangelist of entrepreneurship

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Carl Schramm is on a mission to teach the world to be entrepreneurial

“FORGET space aliens and race cars—here's a game that gives kids skills they can use for the rest of their lives.” So says the blurb for Hot Shot Business, an online game (www.hotshotbusiness.com) played each year by millions of “budding entrepreneurs” who get the chance to open their own pet spa, skateboard factory, landscape-gardening business or comic shop in Opportunity City. Players start marketing campaigns; change products, services and prices; and respond to demanding customers and big news events. And, “as a self-funded entrepreneur, you'll keep all the profits. But if anything goes wrong, well, you're on your own.”

The game was a product of a partnership between the “edutainment” arm of the Walt Disney Company and the charitable Ewing Marion Kauffman Foundation, headed since 2002 by Carl Schramm, now arguably America's leading evangelist of entrepreneurship. Hot Shot Business is one of many initiatives launched by Mr Schramm to educate Americans—and, increasingly, foreigners too—about how to be entrepreneurial. Disney and Kauffman have also developed a popular Opportunity City exhibit in Disney World in Florida. Kauffman has given grants to promote entrepreneurship in American universities; and not just in business schools but across the entire campus. “Entrepreneurs mostly don't come from business schools,” says Mr Schramm, who worries that with their new courses on corporate social responsibility, social entrepreneurship and the like, B-schools increasingly produce graduates uncomfortable with the cut-and-thrust of real capitalism.

Kauffman also funds research into entrepreneurship and its role in the economy, which Mr Schramm says is greatly underestimated. He argues that a rise in entrepreneurship over the past 25 years has rescued America's economy from the stagflationary nightmare of “bureaucratic capitalism”. “What we are engaged in is nothing less than a U-turn in economic history,” he claims. “And the name we give this U-turn is the invention of entrepreneurial capitalism.”

Replacing the old “industrial triangle” of government, big business and the unions is a “new kind of entrepreneurial box”, in which start-ups increasingly take on the work of innovation from big business and the unions have been replaced by universities, he says.

A key moment came in 1980 when America adopted the Bayh-Dole act, giving universities a serious financial stake in the intellectual property generated by their research. Yet Mr Schramm worries that universities are becoming too bureaucratic in their approach to intellectual property, creating a new bottleneck in the transfer of technology to start-ups. Several big firms have told Mr Schramm recently that they are considering switching research to universities in some developing countries, because there will be no question over who owns the rights to a breakthrough in those countries.

The university bottleneck is number two in Mr Schramm's top three worries. Number three is that favourite bugbear of American businessmen, an anti-corporate attitude that spawns burdensome government legislation, such as parts of the Sarbanes-Oxley act. But the top worry for Mr Schramm (and many others), is the low quality of much of America's educational system—since the most important ingredient of entrepreneurial capitalism is human capital. Happily, the other main focus of the Kauffman foundation is education: it is funding new approaches to teaching maths and science that Mr Schramm hopes will be imitated nationwide.

Mr Schramm was educated by Jesuits, before becoming an academic economist and then an entrepreneur; he founded two successful health-care firms. His main intellectual influences are Michael Novak, a conservative Catholic theologian; Thomas Sowell, an economist at the conservative Hoover Institution; and Joseph Schumpeter, although Mr Schramm does not share the late economist's gloomy fear that the “creative destruction” of capitalism will eventually be supplanted by the dead hand of socialism. His bogeymen are John Maynard Keynes, John Kenneth Galbraith and the current darling of development policy, Jeffrey Sachs. However, Mr Schramm is no caricature right-winger; he has recruited Bob Litan, a former economic adviser to Jimmy Carter and Bill Clinton, to run Kauffman's research into entrepreneurship, and is often consulted by Gordon Brown, Britain's Labour prime minister-in-waiting.

Laying foundations

No mere cheerleader for entrepreneurs, Mr Schramm has also had to make some tough managerial decisions at home. When he arrived at the Kauffman Foundation—which gives over $70m a year and, with assets of $1.8 billion, is among the 30 largest foundations in America—it was bloated and inefficient, and, says Mr Schramm, had lost sight of the goals of its founder, who died in 1993. Mr Schramm has reduced the foundation's staff from over 200 to 88, and focused it on pioneering policies in entrepreneurship and education.

Such radical change caused uproar in Kansas City, Missouri, where the foundation is based. The state attorney-general conducted an inquiry into allegations against Mr Schramm, but found nothing. In September 2003, Kauffman's board of trustees rejected a proposal to fire Mr Schramm by just four votes to three. The three then quit, acrimoniously. That may prove a crucial victory not just for Kauffman and the promotion of entrepreneurship. Mr Schramm has become an increasingly influential voice on the issue of how to improve America's foundations, many of which are inefficient, unaccountable and out of touch with their founding vision. Perhaps that could be the subject for a new online game—although judging by Mr Schramm's experiences, it might be much too nasty to be played by children.

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Economist.com WORLD LATIN AMERICA

Brazilian agriculture

The harnessing of nature's bounty

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Getty Images

The inexorable rise of Brazil as an agricultural superpower forms an important backdrop to world trade negotiations

IF GOD is Brazilian, as national folklore would have it, His hometown must be Petrolina. That, at least, is the belief of Arnaldo Eijsink, head of agri-business in Brazil for Carrefour, a French supermarket chain with lots of Brazilian stores. Nature made this district in Brazil's poor north-east an open-air greenhouse, with persistent sun, fertile soil and low humidity, a natural barrier to disease. With the arrival of irrigation, drawn from the São Francisco river, in the early 1980s Petrolina became a horticultural prodigy. Grapes mature in 120 days, compared with 180 in the rest of the world, allowing two harvests a year, says Mr Eijsink. Asparagus can be cut twice as often as in temperate climes.

Other Brazilians might disagree with Mr Eijsink, but only to assert their region's claim to being agriculture's paradise. The state of São Paulo, in the south-east, produces the world's cheapest sugar and orange juice. The endless savannahs of the centre-west are ideal for growing soya, by far Brazil's biggest agricultural commodity. Brazil is the world's largest exporter of beef, coffee, orange juice and sugar, and it is closing fast on the leaders in soya, poultry and pork. Unlike its competitors, Brazil is not running out of land. Agriculture occupies 60m hectares now; it could stretch out to another 90m hectares without touching the Amazon rainforest, says Silvio Crestana, director of Embrapa, the main agricultural research institute.

If rich countries suddenly demolished trade barriers and zeroed out subsidies, Brazilian farming would really shift into overdrive. Full liberalisation would boost the real value of agricultural and food output by 34% and real net farm income by 46%, according to calculations by the World Bank. Under a more realistic scenario, Brazil's income would rise by $3.6 billion a year. That is why the Doha round of multilateral trade talks, which Brazil hopes will dramatically lower barriers to agricultural trade, are so important. Brazilians fret that the round may merely cut “water”, that is, deliver impressive-sounding reductions in maximum tariffs without lowering much the ones

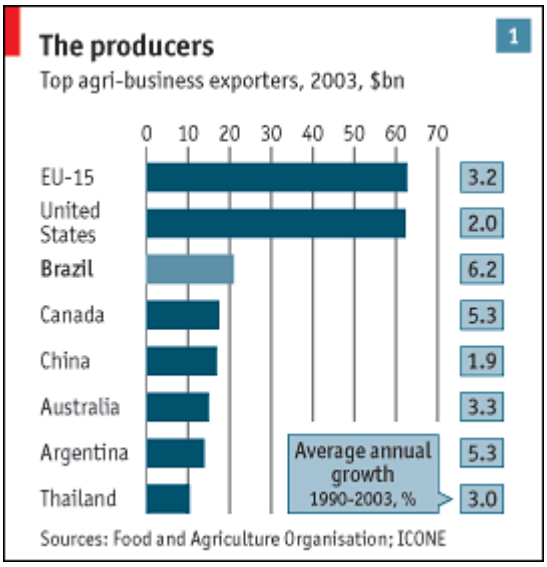
actually applied. “A 50% cut can mean nothing,” says Marcos Jank of ICONE, a pro-liberalisation think-tank. This will be a major topic of conversation when George Bush visits his Brazilian counterpart, Luiz Inácio Lula da Silva, on November 5th-6th.

At the moment, Brazil's farmers are feeling more cursed than blessed. The early 2000s were miraculous years, with buoyant international prices for several of the main export commodities and a competitive exchange rate, which gave exports an extra push. But prices have retreated and, more damagingly, Brazil's *real* has surged against the dollar. Drought struck farmers in the south during the latest growing season. The value of agricultural output (not including ranching) is expected to drop in local currency terms by 16% to 80 billion *reais* ($35 billion) in 2005. Exports of beef, one of the most promising sectors, have been hit by an outbreak of foot-and-mouth disease in the south. Brazil's real interest rates are the world's highest; its system for transporting commodities befits a third-world backwater, not an agricultural superpower.

In the short run, output is likely to grow slowly, if at all. Agroconsult, a consultancy, forecasts a “strong reduction” in the amount of land to be planted with cotton, rice and, for the first time in six years, soya. In June 20,000 farmers and 3,000 tractors descended on Brasília, the national capital, to demand financial relief from the government, the third such demand in little more than a decade. If the government does not comply, “Brazil will lose important markets,” warns Homero Alves Pereira, head of FAMATO, which represents growers in the centre-western state of Mato Grosso.

Brazil's vocation for agriculture will outlast this crisis. It has enhanced its natural endowments with decades of investment in research and development, creating the world's “first competitive tropical agriculture”, in the words of José Roberto Mendonça de Barros, head of MB Associados, an economic consultancy. China's growing appetite for Brazil's produce, sharpened by urbanisation, seems as inevitable as its rise to superpower status.

Yet the pace of Brazil's development is uncertain. It will be determined partly by foreign exchange, interest rates and economic growth. The willingness of producers and the government to grapple with deficits in transport and management will play a big role. Some types of small farm will be left behind. Other obstacles lie in the rich world, whose subsidies and trade barriers undermine Brazil's exports. Within Brazil a debate over what to concede in return for liberalisation of farm trade has revived an old suspicion that the export of commodities is a second-class activity for an ambitious country. Free farm trade by all means, say the doubters, but not at the expense of industry. Through farm trade Brazilians are arguing about what sort of country Brazil should be.



Nature the provider

Agriculture is the Cinderella of Brazil's economy. Brazil's dictators thought industrial development the mark of an advanced country and until the late 1980s exploited agriculture to provide resources for industry and cheap food for the urban masses. Exports and prices were controlled. Cotton farmers, for example, faced quotas on exports, obliging them to supply their product cheaply to the textile industry. The government compensated partially for such restrictions by guaranteeing minimum prices to producers. In the 1990s subsidies shrank and restrictions were

abolished. At the same time, Brazil cut tariffs for imported inputs, improving terms of trade for agriculture.

Foreign investors, some of which had been biding their time in Brazil, seized the opportunity. Trading houses like Cargill, Bunge and Archer Daniels Midland brought relatively cheap finance, infrastructure and international connections to the soya beans and grains. Multinationals like Danone of France and Nestlé of Switzerland snapped up distribution of milk and other dairy products. In 1997 the government eliminated export taxes on commodities, cutting costs by 10-20%, “maybe the biggest stimulus to agriculture in Brazil,” says Sergio Barroso, head of Cargill's local operation. A sharp devaluation of the *real* in 1999 gave another push.

This coincided with an epic migration that began in the late 1970s from the south, the traditional breadbasket, to the savannahs of the centre-west. The movement is still in progress. Land is cheap, so ranchers and farmers can trade in small southern properties for large spreads in the *cerrado*, and the climate is more reliable. The establishment is joining the pioneers. Brascan, a Brazilian-Canadian company, is shifting its beef production from expensive São Paulo to Mato Grosso. The biggest producer of poultry, Sadia, is concentrating new production in the same region. The attraction, says Luiz Murat, the company's financial director, is “the lowest grain cost in the world”. It makes much more sense to ship high-value chickens via Brazil's inefficient transport network than low-value chicken feed. The frontier is spreading to the western fringes of Brazil's impoverished north-east, creating boom towns in Bahia, Piauí and Maranhão.

This has been an undeniable boon for Brazil's economy. At 8.8% of GDP agriculture's share is no higher than in comparable economies, notes a new report by the OECD. Unusually, though, that share has not declined as development advanced. More important, trade in agriculture and related industries accounts for 40% of Brazil's exports and in 2004 for 100% of the $34 billion trade surplus, a vital prop for an indebted economy still vulnerable to crises of confidence. Rural success is not merely a stop-gap, shoring up the economy until industrial development kicks in. “Knowledge applied to nature” can be a foundation of Brazil's development, as it was for Nordic countries, argues Mr Mendonça de Barros. Nokia, Finland's mobile-phone star, was once big in wood pulp.

Brazil has yet to produce a Nokia, but farming provides the outstanding examples of Brazilians inventing technologies rather than importing them. Since the late 19th century agricultural research has “received special attention from the state,” observes Guilherme Leite da Silva Dias, an economist at the University of São Paulo. While planners carved out “market reserves” to defend local industry from competition during the 1970s, Embrapa underwrote the education of its scientists at American and European universities. The conquest of the *cerrado* is the fruit of breakthroughs like the invention of soya varieties that thrive in tropical conditions.

In sugar, a 1970s programme to fuel cars with sugar-based alcohol rather than gasoline combined with Brazilian brainpower to create a high-tech cluster based in the state of São Paulo. In addition to producing the world's lowest-cost sugar and alcohol the state is developing spin-offs that lower the cost further and extend the product line. Bagasse, the crushed dregs of sugar cane, is being burnt for energy and mixed with urea to feed cattle. Eventually it could yield more alcohol and provide the raw material for biodegradable plastic. The top of the sugar chain is flex-fuel cars, which burn alcohol and gasoline in any combination and account for nearly two-

thirds of the new cars sold in Brazil.

Worst foot forwards

Nordic sophistication sits alongside decrepit infrastructure, spotty adherence to the law and lax sanitary practices that are more reminiscent of the third world. Brazilians were rudely reminded of this in October when foot-and-mouth disease broke out in the southern state of Mato Grosso do Sul, prompting the main importers of Brazilian beef, including Russia, Egypt and the European Union, to impose partial bans, marring what had been shaping up as a record year for exports. Ranchers were quick to blame neighbouring Paraguay, which may have been the origin of the infected cows, and the government, which has cut funding for monitoring animal health. But part of the fault apparently lies with ranchers themselves, some of whom ignored some of the regulations requiring the vaccination of their herds.

Ranchers are traditionally a headstrong breed with little patience for the niceties of the law. Some, especially in the north, do not hold clear title to their land, which makes them reluctant to invest; they often hire labour from shady contractors called *gatos*, who sometimes abuse their workers, exposing ranchers to charges of using slave labour. “What we have are good rural producers; what we lack are rural entrepreneurs,” says Frederico Diamantino, a director of the Associação Brasileira dos Criadores de Zebu, the world's largest group of ranchers.

Ranching is a notorious case but not an isolated one. Brazil's world-beating soya farmers have flouted contracts to sell beans to trading companies when they could fetch better prices elsewhere. Southern farmers routinely sow genetically modified soya seeds smuggled in from neighbouring Argentina. Seed piracy has undermined the local industry and lowered the quality of crops. Weak institutions and feeble contracts constitute “the most important challenge to the agricultural sector,” argues Decio Zylbersztajn, another economist at the University of São Paulo.

If so, a close second is Brazil's shaky infrastructure, which blunts much of its edge in the cost of land and labour. Just 10% of the country's roads are paved, compared with 29% in neighbouring Argentina, according to the OECD report. Brazil has neglected its railways, a more sensible way than road to transport grain. Its navigable rivers do not traverse the heart of the country like America's Mississippi but veer off into the Amazon rainforest. Agriculture's march to the *cerrado* has been a march away from consumers. Despite the larger scale of farms in the centre-west, their break-even point is 12% higher than that of southern farms, calculates Fernando Pimentel of AgroSecurity, a consultancy, due largely to higher transport costs. This is also where ranching and agriculture impinge on the Amazon rainforest, the gravest threat to Brazil's image abroad.

The customer is always right

Brazil is addressing these failings, though fitfully rather than systematically. Consumers, both foreign and domestic, are taming agrarian unruliness. Foreigners make their expectations known through chains of enterprises joining retailers in importing countries to farmers in Brazil. With soya, the vital links are the big foreign trading houses along with a few Brazilian firms, such as Incopa. In poultry and pork Brazilian multinationals such as Sadia and Perdigão supply feed and veterinary services among other things to thousands of small farmers, then kill, package and ship the mature animals, often under their own brand. At Sadia's abattoirs in the southeastern state of Paraná some 50m chickens a year face Mecca for slaughter.

In sectors where the processors are small, weak or sloppily run they are becoming less so. The intertwined requirements to export, invest in technology and food safety and raise external finance

are encouraging the emergence of big companies that are transparent enough to withstand public scrutiny and strong enough to take over competitors.

Beef abattoirs are coming round. A decade ago Sadia withdrew from the business because it could not compete with tax-dodging firms. After a doubling of beef exports in the past five years, slaughterhouses are seeking respectability and scale, a trend that will accelerate after the shock of the foot-and-mouth outbreak. More than 20 large and medium-sized slaughterhouses have been sold or rented in the past year, says Marcus Vinícius Pratini de Moraes, head of Brazil's association of beef exporters. Among the acquirers is Friboi, which recently bought the Argentinian operations of Swift Armour. Sadia has re-entered the market.

Foreign investors will join in. Nordzücker, which will close two of its 15 sugar mills in Germany after a tribunal ruled against export subsidies, is scouting for mills in Brazil. Louis Dreyfus, a French company, has bought three sugar mills since 2000. Cargill recently acquired Seara, a poultry and pork company. According to the UN Conference on Trade and Development, $3 billion of foreign and domestic investment is poised to enter the alcohol sector. Beef processing will be another target.

The ideal is “farm-to-fork” food security, which would govern producers as well as processors, but is still some way off. Poultry processors already bring discipline to the “integrated producers” which supply them. Fruit is making progress. Mexican inspectors, familiar with the ins and outs of the United States' customs requirements, help pre-clear Brazilian mangoes for export. Some 500 growers of apples, grapes and mangoes participate in Brazil's “Integrated Fruit Production” programme, which is accepted in the EU. Many ranchers had imagined that their grass-fed beef, thus protected from mad-cow disease, needed no other credential. But the foot-and-mouth outbreak has imparted new urgency to Brazil's project of tagging and tracing each animal from birth to slaughter. About a third of Brazil's 200m-head herd meets this requirement. Friendliness to the environment is another demand with growing weight.

Transport is inching forward. The funnel for grain from the centre-west widened a bit earlier this year when Brasil Ferrovias, an ailing railway company, had its finances reconditioned, clearing the way for the expansion of Ferronorte, a line running from Mato Grosso to the port of Santos in São Paulo state. At its full capacity of 15m tonnes it will cut by 20-25% the cost of shipping out soya compared with the traditional route, through the port of Paranaguá, says Paulo Fleury of COPPEAD, a business school in Rio de Janeiro. Santos itself is more efficient. Three years ago lorries queued up for 60 hours; the outsourcing of traffic management to a private consortium has cut the wait to 18 hours, says Mr Fleury. Santos has now eclipsed Paranaguá as the main outlet for Brazilian soya. Much more needs doing. A new law allows private-public partnerships for infrastructure projects, but investors are still awaiting its implementation.

Farms v factories

Will the Doha round bring down barriers sufficiently to create new trade? America's recent proposal, which is aggressive on tariffs and export subsidies but timid on domestic subsidies, would create more trade than the EU's position, which leans toward slashing domestic support but would limit additional market access. This should somewhat lighten the atmosphere at this week's Bush-Lula talks.

But Brazil has its own inhibitions about the haggling ahead. Farmers fume that by pandering to competition-shy industries the government is spoiling prospects for a free-trade agreement between Mercosur, a trade grouping of four South American countries of which Brazil is by far the biggest member, and the EU. A proposed Free Trade Area of the Americas, to encompass all 34 western-hemisphere democracies, is in cold storage. Farmers fear that protectionist countries will

exploit Brazilian defensiveness to stymie the Doha round.

Trade talks have also set industrial interests based in São Paulo and Manaus, seat of the electronics industry, against the agrarian centre, which is “gaining political weight,” says Marcelo de Paiva Abreu, an economist at the Pontifical Catholic University in Rio de Janeiro. Free trade would hurt some industries. But thanks to sun, soil, science and water, Brazilian agriculture should be a sure winner.

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World trade talks

In the rough

Nov 3rd 2005
From The Economist print edition

The Doha trade round needs some bold strokes to get back on the fairway

Get article background

"WE'RE in deep rough with a partially obstructed shot to the green." Thus one American negotiator sums up the state of the Doha trade negotiations. You do not need to be a golfer to get his point. On December 13th, the world's trade ministers are due to gather in Hong Kong, supposedly to finalise the broad outlines of a World Trade Organisation (WTO) agreement. But despite four years of haggling, the negotiators are at loggerheads over how to free farm trade, have made scant progress on liberalising trade in services and have done virtually nothing on cutting industrial tariffs.

Most attention is focused on farm trade. Although agriculture accounts for only 3% of global output and less than 10% of global trade, it is easily the most distorted sector of the world economy. Slashing trade barriers and subsidies in farming would therefore produce disproportionately large gains, particularly for poorer countries. Of all liberalising measures, cutting tariffs would bring the most benefits. According to the World Bank, over 60% of the gains that Doha promises in goods trade would come from agriculture. The vast majority of this would be won by cutting tariffs.

After months of drift, America's trade negotiators energised the talks on October 10th with a bold proposal: slash the highest tariffs on agricultural goods by 90% and the most trade-distorting farm subsidies by 60%. In response, the European Union made a solid offer to hack back trade-distorting domestic subsidies. However, its proposal on tariffs was so feeble that most negotiators refused to take it seriously.

On October 28th, Peter Mandelson, Europe's trade negotiator, returned with a new offer. He proposed to cut top farm tariffs by 60%, put a ceiling of 100% on any single tariff and reduce the average tariff by 46% (the average cut in farm tariffs, a measure preferred by the Americans, was 39%). This plan is still far less ambitious than that of the Americans or the G20, a group representing big developing countries that includes Brazil and India, which wants rich countries to lop 75% from their top farm tariffs. Worse, the Europeans left themselves acres of wiggle room. For instance, they want to be allowed to classify up to 8% of all farm products as “sensitive” and therefore subject to different rules. According to analysts at the World Bank, if you excuse more than 2% of farm products from the tariff cuts, you lose over 75% of the benefits.

Unsurprisingly, the EU's new offer got a cool reception. The Americans said they were “disappointed”. The G20 was furious at the discrepancy between the Europeans' timidity on cutting farm tariffs and the ambition of their demands for reductions in developing countries' tariffs on industrial goods. The Europeans want levies on agricultural goods to be capped at 100%, but those on industrial products to be at most 15%. Among the poorer countries, this asymmetry caused uproar.

Although Mr Mandelson may be the villain of the moment, he does not deserve all the blame. His room for manoeuvre is narrow. Unlike other WTO negotiators, who can strike deals first and sell them domestically later, Europe's trade tsar can only work within the mandate agreed by the EU's member governments. Several European governments—especially the French—are complaining that he has already exceeded his brief. Jacques Chirac, France's president, warned darkly last week that he would veto any Doha deal that demanded more changes to the common agricultural policy (see article).

Whatsoever a man soweth

Mr Mandelson also has precious little to show for his concessions on agriculture. The Doha negotiators have made even less progress in services and industrial goods than they have on farm trade. That is largely thanks to the big developing countries, such as Brazil and India, which have refused to budge unless they see serious progress on agriculture.

Most negotiators agree that the highest industrial tariffs should be cut by more than the lowest ones. However, there is no common position on how this should be done, let alone on the exemptions that are likely to be granted to developing countries. The Brazilians, Indians and Argentinians reckon that each country should set an individual level of ambition, based on its own average tariff level. Others have scoffed at this idea.

Services are just as disappointing. Even though many of the biggest economic gains from a Doha round will come from freer trade in areas such as financial services, medical services or accountancy, negotiations there are sluggish. Unlike other aspects of the talks, the services deals are decentralised. Each country says what it is prepared to liberalise and lays out what it would like others to do. Most offers have been paltry.

Here, the Europeans have made some bold suggestions. They want agreement that rich countries would offer to liberalise trade in more than 80% of service industries while developing countries should make offers in half. The Europeans also want clear benchmarks against which liberalisation in services can be measured. Although some developing countries, especially India, are keen on far freer trade in services, the impasse on agriculture has stymied progress here too.

The road to Hong Kong

For Hong Kong to be a success, the Europeans must move further on farm tariffs and the G20 must offer something on industrial goods and services. This is still possible. The most important negotiators are meeting in London on November 7th; more will gather in Geneva the next day. There is too little time before Hong Kong to agree every detail of the Doha negotiating framework. But there is enough to make some broad political deals.

Will that happen? Optimists point out that although all sides bluster about the inadequacy of others' proposals, nobody seems to have given up. Importantly, no one has yet talked publicly about downgrading expectations for Hong Kong. Even the most intransigent negotiators will want to avoid a repeat of the acrimony in which two of the past three ministerial gatherings ended, in Seattle in 1999 and Cancún in 2003. A similar collapse in Hong Kong could spell the end, not just of the Doha round, but of the WTO as an effective negotiating forum.

Although necessary, broad agreement between America, the EU and the G20 would not guarantee success. The WTO has 148 members, many of which are deeply sceptical of more trade liberalisation and any of which could cause trouble. The biggest farm protectionists, such as Japan or Norway, have been hiding behind the EU. If Europe offers more, they may still balk. Equally, many poorer countries enjoy preferential access to Europe's markets for farm products, such as bananas. If the Europeans lower their tariffs, these preferences are eroded. They, too, must be coaxed into agreement. Progress between the big players might get the Doha round out of the rough. But it will still be a long way to the hole.

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Economist.com FINANCE & ECONOMICS

Eastern Europe and the euro

Flights to Frankfurt

Nov 3rd 2005 | LJUBLJANA AND TALLINN
From The Economist print edition

Ex-communist countries are struggling to adopt the euro on time

AP

Tall order in Tallinn

Get article background

CHAMPAGNE and flowers would seem the rational way for a club to welcome such a desirable applicant. Estonia, due to adopt the euro on January 1st 2007, is a rare economic star by the debt-drenched, slow-growing standards of the euro zone. Instead of national debt, the state has net assets equal to about 6% of GDP. Whereas growth in the euro area is well under 2%, Estonia's economy last quarter expanded at a cracking 9.9% annual rate.

Estonia's €10 billion ($12 billion) economy makes up just 0.1% of the euro zone's GDP. So it won't change the big picture. Nor will Lithuania and Slovenia, also due to adopt the euro in 2007. But such new members raise big questions about the merits and methods of expanding the euro zone. In old Europe, some Italians are openly questioning the decision to adopt the single currency. But the newcomers are convinced that joining makes sense. They will lose no flexibility: Estonia and Lithuania have currency boards; Slovenia's exchange rate is fixed. Joining will save money (running a separate currency is costly) and, most important, end the risk of speculative attack—a nasty business for a small open economy.

The next question is whether new members would be good for the euro area. The European Central Bank (ECB) expects applicants to meet four criteria. Three are easy for Estonia and the others: sound public finances, low interest rates and consistent exchange-rate stability. But the fourth is that inflation should be no more than 1.5% above the average for the three best EU countries. The bank's assumption is that this will produce a target of around 2.4%. Lithuania and

Slovenia might squeak under the bar. But Estonia, with inflation of 4.9%, stands almost no chance.

One reason for Estonia's high-ish inflation is the rise in the oil price, which, according to the Bank of Estonia, accounts for 2.4 percentage points of the current figure. That will eventually work its way out of the system. The bigger problem, though, is the effect of fast economic growth coupled with a fixed exchange rate. Normally, rising productivity would lead to exchange-rate appreciation; when that can't happen, prices rise instead. Even the ECB accepts this “Balassa-Samuelson effect” (named after the economists who first investigated the issue) could add two percentage points to inflation in a country experiencing fast productivity growth.

In theory, a government could use monetary and fiscal policy to hold back inflation. But in Estonia's case, that is hard. Monetary policy is largely out of the state's hands because of the currency board. The only lever left is to insist that banks have large reserve ratios—Estonian banks already keep 13% of depositors' cash to hand, compared with 2% in the rest of Europe. Fiscal policy offers little scope either. The budget surplus is 2% of GDP, by the Bank of Estonia's estimate. Inducing an artificial recession in order to meet the inflation criteria would be the “economics of the madhouse”, according to Willem Buiter, a former chief economist of the European Bank for Reconstruction and Development now at the London School of Economics.

There is another option: to fiddle the figures, perhaps by cutting fuel taxes to depress inflation. But that horrifies the free-market purists who run the Estonian economy. That is commendable—but also pragmatic. Any one-off measures probably would not work. “They've left it pretty late,” says Edward Parker, who analyses post-communist countries at Fitch, a rating agency. “January 2007 is looking increasingly unlikely.” Estonian officials insist that they are committed to joining as planned. Privately, many acknowledge that a postponement is all but inevitable.

Assuming, that is, that there is no flexibility in Frankfurt. Yet there may be some. Estonia could be assessed a few months after the other two entrants: by then its growth and inflation may have slackened. The ECB can exclude countries with freakishly low rates from its inflation target. And the final decision is made by politicians from the existing euro zone. They may forgive Estonia for getting rich so quickly.

But once you start this, where do you stop? Of the former captive nations that want to adopt the euro, only Slovakia looks on course to meet its target of 2008. Latvia is likely to have to postpone because of high inflation (its growth rate exceeds Estonia's). The Czech Republic and Hungary are unlikely to adopt the euro in 2010 as planned unless they radically change their approach to public spending.

That is particularly true of Poland, which is bigger than all the other new member states combined, and the only one with a free-floating currency. It originally planned to join the euro in 2009, but that now looks very unlikely. Although inflation is low, public finances were already soggy before recent presidential and parliamentary elections. The victorious party, Law and Justice, is a populist, high-spending outfit that shows little enthusiasm for the euro. Lech Kaczynski, the newly elected president, said this week that Poland would “definitely” hold a referendum on adopting the euro, probably in the second half of his five-year term of office.

Estonia's enthusiasm for the euro, and any willingness in Frankfurt and Brussels to tailor the rules to suit new applicants, may thus prove to be a one-off. In the longer run, disdain between moneymen and politicians may prove to be mutual.

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Economist.com FINANCE & ECONOMICS

Romania's bank privatisation

Buy while stocks last

Nov 3rd 2005
From The Economist print edition

Banks in central and eastern Europe used to be cheap. Not any more

CENTRAL and eastern Europe might be known for cheap beer and holidays. However, the prices being paid for the region's banks suggest that not everything there is a bargain.

The imminent sale of a 61.9% stake in state-owned Banca Comerciala Romana (BCR), Romania's biggest bank, may raise €3.4 billion ($4.2 billion). According to Thomson Financial, this beats the record for the region—the recent purchase of Ukraine's Aval Bank by Austria's Raiffeisen International—by $3.2 billion. The BCR deal will cap a two-year, $13 billion spending spree in the region by foreign banks. “It looks like there is no sense in some of the prices that have been paid,” says Grigory Dudarev, of Solid Invest, an investment bank in St Petersburg.

The expected price for BCR, at 4.6 times book value, is a fair bit for a bank with assets of $9 billion and a profit of $201m last year. The Romanian government can demand such a sum because BCR is the last big bank in central and eastern Europe to be offered for sale, and thus offers a final chance for foreigners to gain a foothold in the region.

The last two bidders, Austria's Erste Bank and Banco Comercial Portugues, are hoping that Romania's economy will grow fast enough to make the price worth paying. BCR has the biggest share of loans and deposits in the local market, putting it in a prime position to capitalise on demand for products, such as mortgages and credit cards, that few Romanians could previously afford.

The record of Erste Bank, a serial acquirer of central European banks, indicates that this strategy can work. Its third-quarter results, announced on October 31st, show that the combined net profit of its banks in the region was 55% higher in the first nine months of 2005 than in the same period last year.

But the intensity of the bidding over the past three years has caught everybody by surprise. Some analysts ascribe it not only to the expected convergence of the region's economies with western Europe, but also to banks' desire to satisfy shareholders' intensifying demands for growth. “If you look down the list of bidders for BCR, there are some that show clear commitment to their strategy. Others are looking for a way to deploy capital that they can't deploy profitably in their own market,” says Matthew Clark, of Keefe, Bruyette & Woods, an investment bank. Such strategies might eventually backfire. But that is not the Romanians' problem. It's a seller's market.

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Economist.com FINANCE & ECONOMICS

American International Group

A small matter of $19 billion

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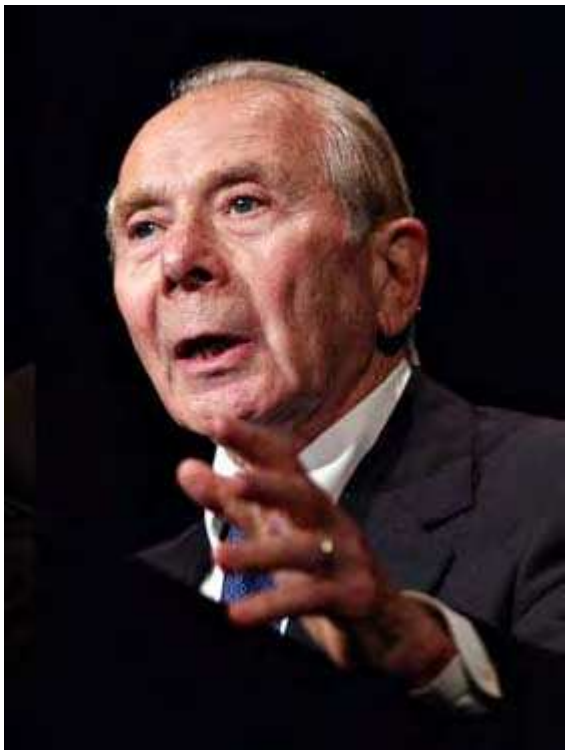
AIG and its former boss are fighting over a load of the insurer's shares

Landov



Greenberg turns on the charm

HANK GREENBERG should be an inspiration to defenestrated chief executives everywhere. Forced out in March after Eliot Spitzer, New York's attorney-general, brought civil charges against American International Group (AIG), Mr Greenberg, following the usual model, should have laid low and prayed that his old pals on the giant insurer's board would pay for a robust defence.

Instead, he has gone on the offensive. He has not been charged with any crime. He has engaged a top public-relations firm. Letters seeking support have been sent to prominent people. A columnist in the *New York Post* wrote kindly about Mr Greenberg's relationship with his small dog. Mr Greenberg himself contributed to the *Wall Street Journal*, decrying anti-Chinese sentiment in America. And he has assembled a fine team of lawyers.

At least some of the cost of this legal team is being borne not by Mr Greenberg but by Starr International (SICO), a private Panamanian company that he controls and whose board he chairs. This firm holds 310m AIG shares, worth $20 billion. It may also be the oddest entity tied to any American corporation.

Named after AIG's founder, Cornelius Starr, Starr received $110m-worth of AIG stock in 1970, after the insurer's initial public offering. The shares and dividends could, presumably, have been retained by AIG's then owners, including Mr Greenberg, but instead the pot has been used as part of the compensation scheme for top AIG executives. This “unprecedented act of individual generosity allowed SICO to inaugurate a tradition of providing very long-term incentives to key managers of American International companies around the world”, according to the insurer's annual report for 2002.

Being included in the Starr scheme was a bit like winning a lottery with strings attached. Those who stayed until retirement became rich. Those who quit early lost the lot. Currently, 700 AIG employees are potential beneficiaries, but they and their predecessors have not come close to emptying the pot. Only 10m shares have been distributed and 23m allocated—leaving 287m, worth $19 billion.

Past remarks by Mr Greenberg and others, and comments like those in that annual report, had given rise to the belief that Starr existed solely to compensate employees of AIG. The 2002 annual report, for instance, noted that “SICO's owners expect that these profit participation plans will continue.” Such stuff is now fodder for the lawyers: that's “expect”, you see, not “promise”. In a court filing on September 27th, AIG charged SICO with breach of contract and unjust enrichment, arguing that SICO held its AIG shares in trust for the insurer's employees and that AIG therefore should have control of them. SICO has responded that this is absolutely untrue.

Settlements in such cases are common. Starr has a reputation for secrecy and might want to avoid the disclosure that a court may demand. And AIG's executives are all Hank's men, the ones that survived his tirades to rise through the ranks. They might be reluctant to fight. Yet a fight seems inevitable. Mr Greenberg will not surrender, and any concession by AIG is, in effect, a loss of equity. Appeasement could expose directors and executives to the accusation that they had given assets away.

If Starr prevails, where will the $19 billion-worth of shares end up? They are controlled by a group of 12 members, of whom Mr Greenberg is one. There are, apparently, lots of restrictions prohibiting anyone directly connected with Starr from using the assets themselves. Mr Greenberg, like other corporate employees, received his own allocations while heading AIG and a similar plan could no doubt be arranged for another purpose.

The ultimate beneficiary should SICO ever be dissolved is the Starr International Charitable Trust of Dublin, which provides $2m a year in local grants and is chaired by Mr Greenberg. With SICO's holdings it would become the world's largest charity after the Gates Foundation. If the trust should somehow come to grief, the next in line is the Starr Foundation in New York, which already has plenty of AIG shares. No prizes for guessing the chairman's name.

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Economist.com FINANCE & ECONOMICS

Vietnam's maiden international bond

Hanoi calling

Nov 3rd 2005 | HONG KONG
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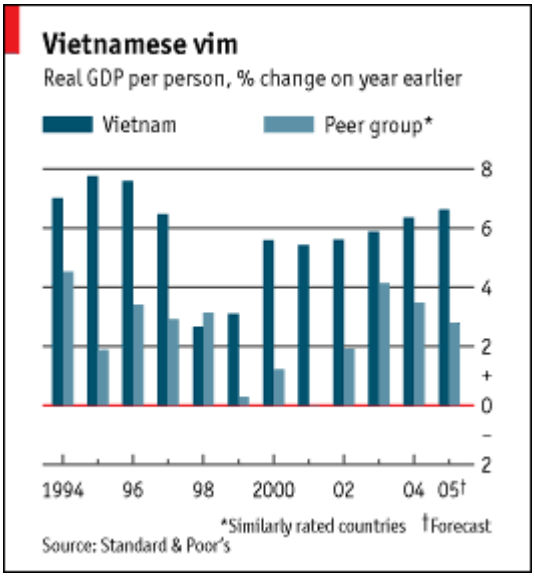
The capital markets welcome another communist refugee

FOR a socialist ingénue, Vietnam is navigating the global financial markets with considerable poise. The country's first overseas government-bond issue, on October 27th, met such strong demand that its size was increased from $500m to $750m and the yield tightened from 7.25% to 7.125%—a mere 2.5 percentage points above that on ten-year American Treasuries and a tighter spread than on comparable bonds from Indonesia and the Philippines.

Novelty and fund managers' desire to diversify their emerging-markets exposure away from large countries like Argentina and Brazil played a part. But Vietnam's attraction goes deeper. Many investors see it as a second China: a communist nation undergoing a steady, state-led transformation to capitalism. The economy is diversified, resource-rich and increasingly open, and is growing fast. GDP per head has risen at an annual rate of 5%-plus for the past five years, much faster than in countries with similar credit ratings (see chart).



Similarities to China do not end there. Secretly, foreign investors like the country's mix of liberal economics and social and political stability (in other words, lack of freedom). The regime in Hanoi has been more cautious than China's in pushing economic development, but its commitment to reform is clear. Vietnam's vibrant private sector has 60% of the economy, at least as big a share as China's. Foreign direct investment is rolling in, at over $2 billion a year. Vietnam hopes to join the World Trade Organisation next summer; WTO membership spurred reform in its vast northern neighbour.

Vietnam does not really need the money. Its public-sector debt is relatively modest at 54% of GDP, calculates Standard & Poor's (S&P), a rating agency, which is why the fresh funds are being spent on new ships for the state shipbuilding company and aircraft for the national airline, rather than anything more urgent. The bond's real significance is that it diversifies Vietnam's sources of financing and establishes a benchmark for future capital raisings, says Le Thi Bang Tam, the vice-finance minister.

The hope is that the country's big corporations, such as PetroVietnam, an oil-and-gas group, Vietnam Airlines and EVN, the state electricity company, will follow the government and raise funds on international markets. Eventually, private companies could too. There is a great need for this given the shallowness of the country's domestic capital markets, says Agost Benard, of S&P. Although Vietnam has two stockmarkets and a domestic bond market, its companies are still too reliant on a ramshackle state banking sector—another parallel with China.

There is a risk that, if allowed to borrow from abroad, Vietnamese companies might borrow too much and investors might lend too willingly. As recently as 1998, $850m of distressed commercial loans from Vietnam were repackaged into so-called Brady bonds because it could not repay them. This time, Hanoi is likely to keep a firmer rein on its charges.

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Economist.com FINANCE & ECONOMICS

Financial exchanges

Shareholder power

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Under pressure from shareholders, Europe's exchanges mull their options

FIVE years ago members of the London Stock Exchange (LSE) voted to take the 200-year-old institution public. On the continent, Germany's Deutsche Börse and Euronext—an amalgamation of several other European bourses—followed suit in the next couple of years. Demutualisation turned Europe's exchanges from organisations owned by and run for their customers, mainly big banks and brokerage firms, into companies expected to maximise shareholder value. At first, banks were shareholders as well as customers, but many sold their stakes to raise capital. Some of them may be kicking themselves today, as the money managers and hedge funds that now dominate the exchanges' boards reap the benefits of rising share prices and greater clout.

The clearest sign of shareholder activism was the ousting in May of Werner Seifert, chief executive of Deutsche Börse, for pursuing his courtship of the LSE. The latest came on November 1st. Atticus Capital, a fund that owns stakes in both Euronext and Deutsche Börse, called for Euronext to end its own lengthy wooing of the LSE and start merger talks with the Germans instead. The same day, Britain's Competition Commission ruled that bids by both continental exchanges for the LSE could proceed, subject to certain conditions. Euronext's management is believed to be open to talks with Deutsche Börse but, having been snubbed in the past, is waiting for the Germans to move first.

It may be that Reto Francioni, who took over as Deutsche Börse's chief executive this week, is more willing to talk to Euronext than Mr Seifert was. However, the practicability of a merger remains in question. A marriage of the two main continental exchanges would be likely to raise regulatory concerns. The two also have very different business models.

Euronext says it is mulling its options. “Whatever we do, it has to create shareholder value,” says an adviser close to the exchange. “We can't do this on strategic value alone.” Similarly, LSE shareholders, buoyed this week by good financial results and a promise that the company will return £250m ($444m) to them, are unlikely to accept anything less than a strong offer.

While shareholders flex their muscles, customers sound frustrated. “Users are concerned the exchanges have too much control,” says Michael Long, of Keefe, Bruyette & Woods, an investment bank. As the London Investment Banking Association has moaned, the cost savings being wrung out of today's leaner exchanges are not being passed on to them. The LSE, for one, has raised its trading fees. The news this week that Eurex US, Deutsche Börse's answer to America's big derivatives exchanges, could close if it does not find a local trading partner is another blow to users, who enjoyed lower trading fees on the Chicago Board of Trade after Eurex US launched its challenge. Recently the Board of Trade has signalled that fees will rise again.

The irony is that exchange users were leading proponents of demutualisation several years ago. Although it is not clear that users have lost out entirely since then—product innovation, operational efficiencies and (at least temporarily) lower fees have all benefited them—their search for alternative trading outlets in both America and Europe indicates a desire to gain new leverage.

In America, a clutch of big exchange users—Citigroup, Credit Suisse First Boston, Morgan Stanley, UBS, Merrill Lynch and Citadel Derivatives Group—bought stakes in the Philadelphia Stock Exchange recently, as a way to counter the growing power of the New York Stock Exchange and NASDAQ. Four big investment firms then announced plans to create a new Boston-based electronic stock exchange, which is not yet operational. In Britain, says Mr Long, there is growing interest among large banks in “internalising” trades off-exchange—matching customers' buy and sell orders before sending net trades to exchanges. This already goes on, but does not yet make sense on a large scale. Nonetheless, he says, this could be a threat to the exchanges in the longer term.

For now, the exchanges' shareholders are much happier than users. Emboldened by the ditching of Mr Seifert, they are unlikely to stop telling executives what they think of their strategies.

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Economist.com FINANCE & ECONOMICS

The future of Parmalat

Bondi and the bankers

Nov 3rd 2005
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Why Parmalat's administrator intends to postpone his retirement

AFP

Who'll get the cream?

Get article background

A FEW months ago Enrico Bondi was looking forward to retirement near Arezzo, in Tuscany. The 71-year-old special administrator of Parmalat was in the last stages of preparing the re-listing on the Milan stock exchange of the Italian dairy group that nearly collapsed two years ago in the wake of corporate Europe's biggest-ever fraud. He planned to bow out at the shareholders' meeting on November 7th-8th. Yet his olive groves will have to wait: Mr Bondi is now up for election as chief executive of the resurrected group.

The change of plan was prompted by a group of investors led by Lehman Brothers, an American investment bank. These shareholders fear that lawsuits Mr Bondi has filed against Parmalat's former financiers would be shelved were he to retire. Mr Bondi believes that banks and regulators should have spotted trouble much sooner, and has sued Italian and foreign banks for more than €13 billion ($16 billion) in damages and restitution.

If Parmalat were a typical company, it would be in the interests of every shareholder to win as much as possible from the bankers. Yet the group's rebirth was possible only because bank creditors swapped some €20 billion in debt-related claims for equity. Ironically, some of Parmalat's biggest shareholders—such as Banca Intesa, Italy's biggest bank, and America's Citigroup and Bank of America—are the very banks in Mr Bondi's sights.

Led by Banca Intesa, the shareholders-cum-defendants tried to assemble their own list of

directors ahead of the general meeting. However, no rival list was submitted before the midnight deadline on October 31st. It turned out to be impossible to match Lehman's heavyweight list, which includes Vittorio Mincato, until recently boss of Eni, a big oil firm; Andrea Guerra, boss of Luxottica, the world's largest maker of spectacles; and Marco De Benedetti, who ran Telecom Italia's mobile-telephone arm until a few weeks ago.

This does not make Mr Bondi certain to become chief executive, however. Banca Intesa's likely allies own more than 30% of Parmalat's shares. If they vote against Mr Bondi, then a new shareholder meeting will have to be called, meaning more uncertainty for the troubled group.

Moreover, behind the scenes some of the banks are working on a plan to sell Parmalat or to break it up. One possible suitor is Granarolo, a much smaller northern Italian dairy group in which Banca Intesa owns a 20% stake. If Granarolo were to buy Parmalat it would probably split off the claims for damages into a special vehicle and sell the international business to Lactalis, a French dairy firm. Granarolo would then have a near-monopoly in fresh milk in the Italian market, but Giovanni Alemanno, the agriculture minister and a member of the far-right National Alliance, seems inclined to support the creation of a national champion. Banca Intesa is helping Granarolo to explore the option of a highly leveraged bid.

Mr Bondi, on the other hand, wants Parmalat to grow. At present it is one of several Italian food firms with sales of €3 billion-5 billion a year. He would like to turn Parmalat into an Italian version of France's Danone. Given that Danone's annual sales are €14 billion, Mr Bondi would have to buy one or more of Parmalat's peer group, such as Ferrero, a chocolate-maker, or Barilla, a pasta company.

This is a plausible plan if Mr Bondi gets his way and the banks eventually pay meaningful compensation for their questionable lending to the old Parmalat. If the creditors-turned-shareholders block his election next week, though, the new company will face more difficulties. Without Mr Bondi, the banks' legal troubles are likely to be far less acute. That, of course, would suit them perfectly.

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Economist.com FINANCE & ECONOMICS

Economics focus

Fruit that falls far from the tree

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From The Economist print edition

Might poor countries gain when their best and brightest leave?

IN THE 2002 football World Cup, France, the reigning world champions, suffered a humiliating defeat to unfancied Senegal. All 11 members of the victorious Senegalese team had played for European clubs. They were not alone. By 2000, the first and second divisions of Europe's leagues had poached enough African players to field 70 teams. So, have greedy European clubs deprived Senegal of its best footballers, or has the prospect of a lucrative career in Europe encouraged more Senegalese to take up the beautiful game?

This question is posed by a new book, “Give Us Your Best and Brightest”, by Devesh Kapur and John McHale. The authors are development economists first, football fans second (if at all). But they see the emigration of African players as a highly visible example of the “brain drain”. Less visible, but more worrying, is the departure of the poor world's doctors, nurses and teachers to more lucrative job markets in the rich world. Ghana, for example, has only 6.2 doctors per 100,000 people. Perhaps three-quarters of its doctors leave within ten years of qualifying.

The answer to the Senegal conundrum is of course “both”: the best players leave, and the dream of emulating them motivates many others to take their place. The real question is whether the second effect outweighs the first, leaving the game in Senegal stronger or weaker than it otherwise would be. A few economists, including Andrew Mountford, of Royal Holloway (part of the University of London), and Oded Stark, of the University of Bonn, think the net effect of the brain drain is similarly ambiguous. The prospect of securing a visa to America or Australia should tempt more people in poor countries to invest in education. Mr Stark calls this a “brain gain”. If the temptation is strong enough, and the chances of landing a visa low enough, the poor country could even come out ahead: it might gain more qualified (if disappointed) doctors and engineers than it loses.

As with all debates about the brain drain, theory has run ahead of evidence. The numbers on international flows of people are much patchier than those on cross-border flows of goods or capital. In a recent paper*, Mr Stark and his co-authors investigate internal migration instead. The rural villages of Mexico lose many of their brightest sons and daughters to jobs in cities or border towns. Those Mexicans who leave their home villages tend to be better educated than those who stay. But despite this, the example the leavers set (and the job leads they provide) raises the average level of schooling of those left behind. Because they can aspire to a world beyond the village, even if they never reach it, young Mexicans have an added reason to stay in school beyond a ninth year, the authors show.

Branches picked bare

Even if the brain drain does leave a country with a better-educated populace, is this necessarily a good thing? Education is not free, and some of those who gambled on a diploma as a ticket

overseas will regret their decision. But Mr Stark assumes that people in poor countries tend to demand too little education. A person's productivity depends on the skills of those around him, as well as his own. Because of these spillovers, an individual's education is worth more to the economy as a whole than it is to himself, and he will underinvest in it as a result. Mr Stark sees limited emigration as one way to fix this market failure.

India's software engineers are perhaps an example of this principle at work. Indian students had little reason to learn computer coding before there was a software industry to employ them. But such an industry could not take root without computer engineers to man it. The dream of a job in Silicon Valley, however, was enough to lure many of India's bright young things into coding, and that was enough to hatch an indigenous software industry where none existed before.

India's valley-dwellers represent just one contingent in a much larger diaspora. According to the most exhaustive study† of the brain drain, released last month by the World Bank, there were 1.04m Indian-born people, educated past secondary school, living in the 30 relatively rich countries of the OECD in 2000. (An unknown number of them acquired their education outside their country of birth, the report notes.) This largely successful diaspora is more than just something to envy and emulate. Its members can be a source of know-how and money, and provide valuable entrées into foreign markets and supply chains.

But Messrs Kapur and McHale think India's relatively happy experience with its educated emigrés is more likely to be the exception than the rule. Its million-strong brain drain represents just 4.3% of its vast graduate population, according to the Bank. By contrast, almost 47% of Ghana's highly educated native sons live in the OECD; for Guyana, the figure is 89%. This is not a stimulative leeching of talent; it is a haemorrhage.

Emigration, as Mr Stark suggests, might be a spur to greater accomplishment, and the poor world's talent, like Senegal's footballers, deserves a chance to compete on a global stage. But it is not easy to run a managed “emigration” policy. The drain of educated minds from poor countries is mostly determined by host countries' rules, not home countries' interests. There will be tremendous pressure to loosen those rules in the future, not least because, as the baby-boom generation retires, it will seek to “backfill the taxpaying workforce behind it”, as Messrs Kapur and McHale put it. The rich world no longer welcomes the tired and the huddled; it looks set to compete ever more fiercely for the bright and the qualified.

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* “A Gain with a Drain? Evidence from Rural Mexico on the New Economics of the Brain Drain”, by Steve Boucher, Oded Stark and J. Edward Taylor. August 2005.

† “International Migration, Remittances and the Brain Drain”, edited by Maurice Schiff and Caglar Ozden.

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Economist.com SCIENCE & TECHNOLOGY

MRSA

The struggle against superbugs

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Reports from the frontline of the battle between man and bacteria

RARELY does a bacterium become the fuel for a national election campaign. *Staphylococcus aureus*, though, won just such a dubious distinction earlier this year when a drug-resistant form known as MRSA became a byword for the filthy state of British hospitals. As ever, the truth is more prosaic than election hype. MRSA is a global problem, as indeed is the rise of other drug-resistant "superbugs". Science is struggling to cope. There are too few new antibiotics in the pipeline and hopes were dashed this week that a vaccine against *S.aureus* might be developed soon.

Three billion years of evolution have turned *S.aureus* into a pretty mean bacterium. Although it is found on human skin, its preferred habitat is up the nose. When it gets inside the body, it can manifest itself as anything from harmless pimples to life-threatening diseases, such as endocarditis (inflammation of the heart tissue) and septicaemia. The over use of antibiotics in the past 50 years means that *S.aureus* is now resistant to treatment. In America alone, every year 2m people acquire bacterial infections while in hospital and 90,000 of them die as a result, according to the Centres for Disease Control and Prevention in Atlanta. The methicillin-resistant strain of *S.aureus*, MRSA, is of particular concern. Infections are a growing global problem.

First spotted in 1961, MRSA is now endemic in many hospitals. In many Asian countries 70-80% of the strains isolated from diseased tissue have the MRSA form of *S.aureus*. In America, the figure is around 40%. In Britain, the percentage of death certificates mentioning it as a factor contributing to death has shown a staggering rise since 1993. The disease is also hyper-endemic in Italy, Turkey and Argentina. And, in a study published earlier this year, among 500 otherwise

healthy children attending a hospital outpatient clinic in Nashville, 9.2% had MRSA up their noses. The same study three years earlier had put this figure at 0.8%.

How to win the war

According to the *Lancet*, countries that have more or less ignored MRSA—such as China, South Korea and Japan—have some of the highest rates of incidence. Meanwhile, those with a low prevalence of MRSA—such as Finland, Denmark and the Netherlands—have high levels of surveillance and strictly enforced contact precautions. The bug's spread can be greatly reduced by scrupulous hygiene. Hospitals in the Netherlands isolate patients with MRSA and screen everyone who comes into contact with them.

Once a patient has become ill with MRSA, there are only a few expensive antibiotics left that can treat it. Strains resistant to these are already emerging. It is a war—between man and a bacterium—and the outcome is by no means certain.

Many people believe that the main stumbling block is a lack of new antibiotics. Fewer and fewer antibiotics are being discovered. Richard Wise, who chairs the committee on anti-microbial resistance for the Department of Health in Britain, is one of many who are concerned. Of those few new drugs that have emerged, he says, most are not sufficiently novel to combat resistance to old drugs.

Antibiotics are not big earners for the pharmaceutical companies. Drugs for chronic conditions are far more profitable because they keep working and remain saleable—unlike antibiotics. In December this year, the British Department of Health will bring industry and academia together to try to address some of these problems in Europe. It won't be easy. Most drug companies have cut back on their efforts. An American study last year found that out of 506 drugs in development, only five were new antibiotics.

Others think that vaccines might be the answer. Because antibiotics attack bacteria directly, this leads to an evolutionary pressure on the bacteria to evade this. Vaccines, though, stimulate the body to mount its own, far more deft, defences. According to Alison Holmes, director of infection control and prevention at Hammersmith Hospital in London, because vaccines reduce infection in the first place, they cut the volume of antibiotics used to treat the infection and thus would slow down the emergence of new superbugs.

Two companies are working on a vaccine that, in theory, would work against *S.aureus*. Such a vaccine could be used in one of several ways. It might be given to people who were about to undergo an invasive procedure or operation—such as cardiac surgery—which would reduce the risk of complications and need for antibiotics. Or, if the vaccine were long lasting, it might be given to people who were at a continuing risk from *S.aureus* infection, such as those undergoing kidney dialysis.

Vaccine Research International, a small private company based in Birmingham, is about to end the first phase of a clinical trial of a vaccine aimed at *Staphylococcal* infections. It hopes the drug—based on a whole but inactivated organism—might be used to address the problem of infections in joint-replacement patients. The results are due in January next year.

Nabi Biopharmaceuticals, based in Rockville, Maryland, is further ahead with its trials. Until this week, Nabi had hoped to launch its vaccine, initially for dialysis patients, in Europe in 2006, subject to a final confirmatory clinical trial. Unfortunately, on November 1st, Nabi was forced to halt work when it failed to confirm an earlier confirmatory clinical trial that showed it protected these patients.

This is not necessarily the end of the road. The problem may be a glitch in production, or the difficulties of immunising dialysis patients whose underlying conditions mean they often have weakened immune systems. Nabi says it pushed ahead with the vaccine for this group first because the clinical need was so great. Other groups of patients may be able to produce a better immune response to the vaccine.

The Nabi vaccine is only a portion of the actual bacterium attached to a carrier protein that stimulates the immune system. Judith Davies, a spokesperson for Vaccine Research International, argues that the history of vaccines shows that more broad-ranging and longer lasting immunity tends to come from vaccines based on complete organisms, such as the one developed by her company. Nabi disagrees, but even if the halting of its trials is later attributed to a trivial problem, it will take several years to get to this stage again.

It remains to be seen whether a vaccine against MRSA can be developed. Vaccinating against bacterial pathogens, rather than treating them with antibiotics, is a promising route forward. If they can be made to work, prevention would be, as ever, better than cure.

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Economist.com SCIENCE & TECHNOLOGY

Endangered species

Bearing up

Nov 3rd 2005 | YELLOWSTONE
From The Economist print edition

Grizzly bears have made an astonishing comeback in Yellowstone National Park

THE grizzly bear (*Ursus horribilis*) once roamed America from the Great Plains to the Pacific Ocean. By 1975, its numbers had fallen so far that it was listed as threatened under the Endangered Species Act. Today, scientists estimate that there are 1,200 grizzly bears in America outside Alaska. Of these bears, the largest population lives in and around the Yellowstone National Park in the states of Idaho, Wyoming and Montana. The recovery of this population has been so successful that it could be taken off the endangered list.

The grizzly bear's most recent decline in the Yellowstone area began in the 1960s, when hungry bears began to rummage through rubbish skips and picnic baskets. Bears and humans grew overly accustomed to one another and, on a single night in 1967, two backpackers were killed in separate bear attacks as they slept in Glacier National Park in Montana.

Fearing similar tragedies, Yellowstone Park officials decided it was time for grizzly bears to return to a wild diet. Bears unable to quit junk food were shot: 220 were killed between 1969 and 1971. Worried that more losses would condemn the species to eventual extinction in the region, the federal government listed grizzly bears as a threatened species, and biologists initiated recovery efforts.

The comeback may represent the biggest accomplishment of the Endangered Species Act to date. In the early 1980s, the park had 200 bears; today, the figure is 600. The population is growing at between 4% and 7% a year. Many scientists think that the park is already home to as many bears as its 2.2m acres can support. Radio collar signals show grizzlies ranging well beyond park borders, across 9m acres.

The plight of the white-bark pine—a favourite food for the bears—might yet alter this healthy picture. At present, grizzly bears are kept in remote areas by the presence of the pine. In years when the trees produce fewer cones inside the park and its immediate surrounds, more bears venture out into human settlements to look for food. And, not surprisingly, more bears get shot. White-bark pine is currently under attack—by the mountain pine beetle and a fungal disease called blister rust.

The mountain pine beetle is a new threat. Historically, the beetle could not attack the pines because they grew in harsh climates with extreme winter frosts. Ecologists think that global warming may have led to warmer winters, allowing the beetles to expand into the pine's habitat. The pines have no evolved defence against the beetle and are succumbing fast.

A second threat to white-bark pine is blister rust, which is killing many trees. Occasional resistant individuals occur but, in the short to medium term, a severe population decline is expected. Government scientists estimate that, if all the white-bark pine went, bear population growth would fall to just 1% a year.

Biologists who want to see grizzly bears succeed in the American west are aware that they must also win the support of local people. The growing number of bears outside the park is troubling farmers and ranchers. Cattle losses to grizzly bears in Wyoming, alone, were estimated at $117,000 in 2004.

Defenders of Wildlife, an organisation devoted to the protection of native species in their natural homes, is one of several groups that compensates local landowners for any livestock lost to grizzly bears. It has paid more than $100,000 in compensation since 1997 and has invested another $364,000 in projects to prevent future problems created by predators. Concern for bear protection has even led to the development of a new eco-label: Predator Friendly. Started by a group of sheep ranchers, the label certifies that farmers will not shoot wolves, grizzly bears or mountain lions that prey upon their livestock. The farmers can then charge a premium for their carnivore-friendly products.

Staff at the Wind River Bear Institute, another organisation dedicated to bear conservation, teach individual bears to stay away from human settlements. Using dogs that were originally bred for hunting brown bears in Finland, they herd bears away from ranches or residential areas. Preliminary results in Glacier National Park suggest the method works.

One of the biggest challenges to bear conservationists over the coming decades will be to connect existing bear populations to one another. The Yellowstone to Yukon Conservation Initiative aims to create a strategically situated corridor of wildlife habitat that would allow grizzly bears to move around human settlements for 1,990 miles, from Yellowstone National Park northwards almost as far as the Arctic Circle. The Nature Conservancy of Canada has already signed a deal with Tembec, a large Canadian timber company, to protect 100,000 acres in British Columbia. A number of bridges have also been built across roads to help grizzly bears move between pieces of habitat in the Rockies.

Suzanne Lewis, the superintendent of Yellowstone National Park, describes the initiative as “daunting, but exciting”—suggesting the project may, indeed, prove a fitting next chapter in the nerve-wracking history of the grizzly bear.

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Economist.com SCIENCE & TECHNOLOGY

Mating songs

Melodic mice

Nov 3rd 2005
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Male mice sing when they scent the female of the species

PRESENTED with the possibility of sex, creatures can behave in odd ways. One strategy is to burst into song. Birds and amphibians have long been known to croon in the presence of a potential mate, but among mammals only humans, whales and bats were thought to serenade a possible partner. Now the humble mouse has joined the list.

Timothy Holy and Zhongsheng Guo of the Washington University in St Louis, Missouri, made the discovery after studying how male mice respond to female mouse pheromones, the chemical signals linked, among other things, to mating. The mice made noises inaudible to the human ear, and the researchers recorded and analysed them.

By dropping the pitch of the recordings so that humans could hear it, the researchers found that it sounded remarkably like birdsong. Each mouse made a series of “chirps” with bursts of closely spaced notes interspersed with lulls. Details were published this week in the *Public Library of Science Biology*.

To be classified as a song, a vocalisation has to contain distinct notes, rather than one sound repeated, as well as motifs and themes that recur from time to time. The researchers identified distinct clusters of pitch changes in the songs by analysing a set of 750 syllables produced by one mouse in a single 210-second recording. They concluded that these pitch changes followed a pattern and were thus a song. Tests with 45 different mice produced similar results, although each mouse had its distinct *chanson*.

Exactly why mice sing is not yet known, but given that the males are stimulated to sing when they smell female pheromones, it seems likely that it is to do with sex. If so, the song should contain information about their quality as a potential mate. The researchers will now investigate this possibility. They also plan to examine whether wild mice sing different songs to laboratory mice.

Moreover, as the mouse genome has been mapped it may be possible to discover fundamental principles about the genetic contributions to singing and the learning of songs. This could uncover basic truths about the brain and, researchers say, may eventually help scientists better understand disorders of communication, such as autism.

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Economist.com SCIENCE & TECHNOLOGY

Climate change

Feverish analysis

Nov 3rd 2005
From The Economist print edition

Global warming may damage health and cause fatal disease. Perhaps

Get article background

FOR decades, scientists have warned about global warming's likely impact on the environment. Study after study has predicted rising sea levels, shifting ecosystems and erratic and more intense storm patterns. But could global warming pose a direct risk to human health too?

A three-year study by researchers working on the Climate Change Futures Project at Harvard Medical School's Centre for Health and the Global Environment suggests that it could. The researchers argue that global warming exacerbates freak events such as hurricanes, flooding and heat waves, and that these in turn spread disease and death.

For example, Mozambique endured severe floods a few years ago and also suffered an outbreak of malaria. Paul Epstein, who led the research, says that previous studies of climate change and malaria typically studied the impact in high altitudes. The new report scrutinised lowlands, too, and concluded that the freak Mozambique flooding—the sort of event climate change may encourage—led to a five-fold increase in malaria.

More controversially, Dr Epstein proposes a link between an increase in emissions of carbon dioxide, the principal greenhouse gas, and the rise of asthma. For reasons scientists do not fully understand, asthma rates have been increasing globally. In American cities, they have risen four-fold in recent years. The usual suspects are particulates from diesel combustion and dust mites. Dr Epstein offers a novel twist: he thinks that rising carbon dioxide concentrations may be promoting the growth of ragweed, pollen and fungus. Those irritants, he reckons, may be aggravating asthma.

The report concludes that global warming favours the spread of disease—especially if that warming leads to extreme weather events like Hurricane Katrina or the killer heat wave that struck France a few summers ago. Humans and ecosystems alike are particularly vulnerable to disease if the “return time” between extreme events shortens in future.

The project was supported by the United Nations Development Programme, whose primary focus is poverty, and Swiss Re, a reinsurance giant devoted to managing global risk. They are appropriate sponsors for a study that has reached gloomy conclusions with nasty implications for both health and finance.

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Economist.com BOOKS & ARTS

Chinese treasures

Qing bling

Nov 3rd 2005
From The Economist print edition

A rare display of the grand imperial art that was created for China's Qing emperors makes for one of the finest, and most unusual shows of the season

THE three Qing emperors who reigned for 133 years, until 1795, were among the greatest rulers ever. Under their influence, China's empire doubled in size, becoming one of the most powerful and prosperous nations of its time. To reinforce control of their newly minted multi-ethnic realm, the Qing rulers commissioned a spectacular and highly diverse art that can be seen in a new exhibition in London.

The Qing (pronounced “ching”) were Manchu warriors from the north, who wrested power from the Ming empire in 1644. Instead of destroying the Chinese culture they had conquered, the Qing embraced it, learning Chinese, moving into the Forbidden City, maintaining its Confucian bureaucracy and practising the various sects of Buddhism found throughout the empire. The only Chinese custom they did not adopt was foot-binding for women, which they regarded as barbaric.

Leading the trio was the Kangxi emperor, who ascended the throne as a child in 1662. For Kangxi and his two heirs, Yongzheng and Qianlong, the mastery of Chinese art, culture and religion proved their legitimate right to rule as the “sons of heaven”, the mediators between the heavenly and natural realms.

Some of the most dramatic pieces in the show are the painted scrolls that portray Kangxi on his inspection tours of southern China, commemorative images that were commissioned after he had quelled rebellions there. Up to 70 metres long, they depict in such intricate detail the various episodes in the journey that they make the viewer feel almost physically part of the picture. These, together with over 100 other court paintings, are the stars of the exhibition, all of them displayed in galleries that evoke a mini-Imperial City. Because of their scale and fragility, most have never been seen before, not even in China.

After the British Museum cancelled a smaller show of Qing dynasty art a few years ago, Dame Jessica Rawson, then the keeper of oriental antiquities at the British Museum and now warden of Merton College, Oxford, knew that the Chinese were still keen to display their treasures abroad. The new exhibition is the result of a sustained and careful campaign of negotiation led by Dame Jessica, who has been travelling to China for three decades and is very well connected there. “I am known as a person who can be trusted,” she says. “And for my steely resolve, which is respected in China.”

Dame Jessica also knew that the Palace Museum in Beijing, from which most of these treasures have been sent, wants to market itself as an important international lending museum; it can only show a fraction of its collection of over 1m objects at any one time. The Royal Academy has strong historical links with the museum; in 1935 it was the first foreign gallery to show treasures from the Forbidden City, something that the Chinese had not forgotten. This year also marks the museum's 80th birthday, and an impressive overseas show was felt to be an appropriate way to celebrate. (Chinese officials made a special visit to London last year to check that the Royal

Academy was sufficiently grand.)

However, the negotiations over which pieces should be there were still complex. There is no inventory of the Palace Museum collection, so Dame Jessica put together a team of expert co-curators, each of whom acted like a detective, scouring the published sources to select objects. When the museum refused Dame Jessica's request for an octagonal lacquer box, claiming it had been taken to Taiwan by Chiang Kai Shek in 1949, one of the curators was able to cite an article from a Japanese journal locating the piece in the Palace Museum, and it was produced. Some requests were refused by the museum, which then found itself overruled by the Department of Culture and Heritage, proving that at the highest levels there was an interest in making this exhibition a success.

Indeed, the Chinese government sets such store by this show that it asked the Royal Academy to open it two months early to coincide with the state visit of President Hu Jintao. What connection could the president of the People's Republic of China feel with the emperors who ruled the Celestial Kingdom? More than you might think, says Dame Jessica. “The past is a valuable part of the present in China—much more so than it would have been 50 years ago. The Chinese want to make a huge impression with this show.” Which is why Tony Blair will be standing alongside Mr Hu when they cut the ribbon.

“China: The Three Emperors, 1662-1795” is at the Royal Academy of Arts, London, from November 12th until April 17th

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Economist.com BOOKS & ARTS

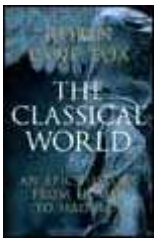
Greece and Rome

An epic epic

Nov 3rd 2005
From The Economist print edition

HOLLYWOOD film directors do not ordinarily take time out to plug books by distinguished Oxford historians. Yet Robin Lane Fox's epic history of Rome and Greece comes with a dustjacket blurb from Oliver Stone about the author's earlier book on Alexander the Great. In fact Mr Lane Fox's involvement in Mr Stone's film "Alexander" was more hands-on than this might suggest: one cavalry charge had the Oxford don clinging to a four-legged extra.

The Classical World: An Epic History from Homer to Hadrian
By Robin Lane Fox



Penguin/Allen Lane; 694 pages; £25

Buy it at
Amazon.co.uk

Lest an association with a director who likes his elephants computer-generated and his Alexander with blond highlights should put anyone off, it is worth saying straightaway that "The Classical World" is a more epic epic than any toga-clad celluloid effort to date.

The book opens with a cinematic flash forward. Mr Lane Fox's subject is the political, military and, to some extent, social history of Greece and Rome from the mid-700s BC, when Homer, or whoever became Homer, was declaiming his poetry, to 117AD, when Hadrian succeeded Trajan as emperor. But we start with Hadrian, whose enthusiasm for Greek civilisation extended to his bedroom: he fell in love in an un-Roman way with a man, just like Alexander the Great. But whereas Alexander promoted a cult of his dead lover, Hephaestion, Hadrian sought to go one better in his imitation, raising the dead Antinous to the status of a god.

References to Hadrian and what he might have made of the goings on of fourth-century Athenians are sprinkled throughout the book. This is because Mr Lane Fox thinks that separating the rise of Rome from the rise and fall of Greece (in its Spartan, Athenian, Theban and then Macedonian guises) as the dominant power in the classical world downplays the common elements in both their stories. Aristotle, he points out, heard about a destructive raid on Rome by barbarian Gauls in about 390BC. Several Roman senators in 200BC would have spoken and written Greek. This broad sweep also allows Mr Lane Fox to tackle three common themes—freedom, justice and luxury—which drift gently in and out of the narrative.

The story of freedom describes, of course, something much more limited than Delacroix's bare-breasted Liberty. At its most extensive in Greece, it amounted to the power that adult male Athenians enjoyed in shaping how the city's control of women, slaves and other conquests would be exercised. Even that was a little too much liberty to last for very long. Justice in both Greece and Rome varied in law according to the relative status of the perpetrator and the victim of a crime. In the case of Philip of Macedon and his son Alexander, it became the personal gift of the king.

Only luxury, and the troubles that seemed invariably to result when it abounded, would be recognisable to the audience of Mr Stone's "Alexander", though ancient extravagance can sometimes look surprisingly bourgeois. The attachment that some Roman senators felt for their

ornamental fishponds, which was noted so disapprovingly by Cicero, is one good example. Swapping freedom for a fishpond is a trade that anyone preferring a quiet time might be tempted to make when faced with a resurgent Caesar. But it would deny the swapper a main part in Mr Lane Fox's brilliant book, where soldiers, poets and orators fight for attention in a story that is never cluttered and always stimulating.

The Classical World: An Epic History from Homer to Hadrian.
By Robin Lane Fox.
Penguin/Allen Lane; 694 pages; £25

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Economist.com BOOKS & ARTS

Why things cost what they cost

Gumshoe economics

Nov 3rd 2005
From The Economist print edition

MOST economists are nine-to-fivers. Calculating rationalists during the working day, they are much like the rest of us when they are at home with their boots off. But Tim Harford, who works at the World Bank and writes a regular newspaper column, never seems to take off his boots at all. He sees the fingerprints of supply and demand everywhere he looks: at work and at play, sipping coffee, shopping for groceries, even playing poker with friends.

His new book, “The Undercover Economist”, is a playful guide to the economics of everyday life, and as such is something of an elder sibling to Steven Levitt's wild child, the hugely successful “Freakonomics”, which came out earlier this year.

While Mr Levitt wanders freely among sumo wrestlers, game-show contestants and other inhabitants of the outer fringes of economics, Mr Harford takes care of the home turf—scarcity, competition, taxes and trade. He is happy to learn from his elders, which is all to the good. The best stuff is not always the latest stuff, after all. As far back as 1817, David Ricardo explained why the best farmland often makes money for the landlord, not the farmer. And his analysis serves perfectly well to explain why today's coffee companies don't make much money from a high-priced *latte* in Waterloo railway station.

The Undercover Economist: Exposing Why the Rich Are Rich, the Poor Are Poor—and Why You Can Never Buy a Decent Used Car!
By Tim Harford

Oxford University Press; 288 pages; $26. To be published in Britain by Little, Brown in March

Buy it at
Amazon.com
Amazon.co.uk

That said, Mr Harford does not take himself too seriously. He is at his best illuminating the economics of small things. He rehearses some of the familiar arguments in favour of globalisation and mounts a spirited defence of competitive markets, on the grounds that they discover the “truth” about our wants, and how much it costs to meet them. (Taxes, which make some things more costly than they truly are, in order to make other things cheaper, are a kind of “lie”, he says, though often a white one.)

He also makes some impish forays into charged issues, such as environmentalism, which he thinks too important to be left to the moralists. But in general, as befits a covert operative, his tone is quizzical and low-key, rather than bombastic and judgmental.

For anyone schooled in blackboard economics, “The Undercover Economist” succeeds in taking the chalkdust out of the subject. But does it also serve the reader who has no economics at all? The difficulty is to avoid talking over readers' heads, without talking down to them either. It is a trick Mr Harford carries off well, for the most part, though he can sometimes seem almost too anxious to entertain. The best detective stories are usually told straight.

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William Shakespeare

All the world's a stage

Nov 3rd 2005
From The Economist print edition

WILLIAM SHAKESPEARE has been sliced this way and that—biographically, literarily, culturally, theatrically and historically. Now James Shapiro, professor of English at Columbia University, has found a new and richly yielding angle.

A Year in the Life of William Shakespeare: 1599
By James Shapiro

HarperCollins; 416 pages; $27.95.
Faber and Faber; £16.99

Buy it at
Amazon.com
Amazon.co.uk

1599 was the year in which the Globe was built, the theatre for which "Henry V" was completed, the year that "Julius Caesar" and "As You Like It" were written, and (possibly) the first draft of "Hamlet". It was also a year of nasty politics, state censorship and book burning. The ageing Elizabeth I was an embattled, heirless monarch, under threat from sedition at home, from the Spanish, from the Irish and, most bitterly, from the Earl of Essex, the very man sent to quell them.

By voracious reading and a sharp eye for detail, Mr Shapiro helps us hear the plays through a buzz of contemporary voices—religious, loyal, sceptical, iconoclastic, seditious. "I care not a turd for the Queen nor her precepts," says a certain Mary Bunton in a trial transcript. On the other hand, the rousing rhetoric of King Henry V in Shakespeare's play is accompanied by the voice of a preacher, Lancelot Andrewes, making the same points with the same thump and thrill on the eve of Essex's departure for Ireland. Ireland? Ireland was no Agincourt, but the underside of "God for Harry, England and St George!", a reminder of high taxes, ragged conscripts, corrupt officers and of "all those legs and arms and heads chopped off in a battle", as one of Shakespeare's soldiers says on the eve of that other battle, in France. Is war glorious or not? By re-animating the political moment, Mr Shapiro shows how Shakespeare had it both ways.

But Mr Shapiro's point is not simply topicality. What strikes him most about Shakespeare is his sensitivity to "the epochal, to moments of profound shifts"; tipping points between Catholicism and Protestantism; between religion and secularism; between the nobility and the merchant class, the chivalric knight and the bureaucrat, the hero and the sceptic. This complex and wide-ranging book was a huge critical success when it was published in Britain earlier this year. American readers, for whom the book is now just available, are also likely to enjoy Mr Shapiro's nose for the crystallising event or quote that makes these pairs of opposing concepts almost palpable.

Take, for example, this happy find: George Silver's book on weaponry, which was published in 1599, of course, and which falls in so sweetly with Mr Shapiro's argument about the passing of chivalric values, with his comparison of the two versions of "Hamlet", and with how these things relate to the career of Essex.

In it, the author laments the abandonment of the short sword of "our forefathers" (the weapon presumably of Hamlet's father and old Fortinbras) in favour of the Frenchified rapier and dagger (Osric's and Laertes's weapons). This, Silver complains, represents nothing less than the death of

valour.

As it happens, the book is dedicated to the Earl of Essex, the man who seemed to his contemporaries to embody just that dying order. He is an aspect of Henry V, an aspect of Caesar, above all, he is young Fortinbras in “Hamlet”, leading his 20,000 men to their deaths “even for an eggshell”. Meanwhile, Hamlet looks on, agonising over his own dishonourable inaction and yet sceptical of Fortinbras's honourable action. It is a cusp moment. 1599, as Mr Shapiro shows, was a good year for cusps—and, by the same token, for Shakespeare's peculiar genius.

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By James Shapiro.
HarperCollins; 416 pages; $27.95.
Faber and Faber; £16.99

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The Gunpowder Plot

Remember, remember

Nov 3rd 2005
From The Economist print edition

ON NOVEMBER 5th 1605, a band of English Catholic hotheads planned to detonate 36 barrels of gunpowder under the House of Lords. The scheme, dubbed by one contemporary “the quintessence of Satan's policy”, would have decapitated the nation by wiping out MPs, lords, bishops and the king. For sheer terrorist ambition, the plot remains unmatched. So why has this plan, and the capture, torture and public execution of the leading conspirators, been celebrated in Britain for the past four centuries?

“God's Secret Agents” suggests one reason why: anti-Catholic paranoia. The plot was the “popish” outrage that Protestants had expected and warned about for half a century. Such fears had resulted in fines, draconian laws and show trials of Jesuit missionaries. It is as though Anglicanism—a vague and ambiguous creed, even in its early days—required an enemy against which to test itself.

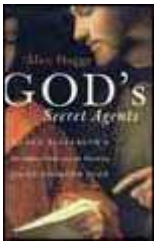
Before 1605, the threat from Catholicism was mostly imaginary. Attempts to re-establish the old religion in England were doomed to failure. Missionaries concentrated on the nobility, reckoning they would in turn convert the rest of the population, but this was to misunderstand English society. Worst, the missionaries received little support from Rome or Spain. The Gunpowder Plot was a desperate last heave by men who had already failed.

It was also a gift to the authorities. The plot had been so wide-ranging that every pillar of the state—monarchy, church, nobility and Parliament—could interpret its survival as an act of divine providence. All had an interest in keeping the memory of Catholic perfidy alive. As one preacher put it in 1636, the day was “never to be cancelled out of the calendar, but to be written in every man's heart for ever.”

But then, something rather odd happened. What began as a celebration of the status quo became the opposite. By the 18th century, Bonfire Night had become an excuse for violence and barely disguised extortion. Respectable citizens who tried to suppress it were burned in effigy for their pains, alongside the pope—a tradition that survives in the Sussex town of Lewes.

This peculiar transformation is the subject of “Gunpowder Plots”, a book of essays. It is a mixed bag, but two stand out: an elegant account of the evolution of Bonfire Night, by David Cressy, an historian, and a nerdy and fascinating treatise on gunpowder and fireworks, by Brenda Buchanan. The latter contains an intriguing detail. A receipt dated November 1605

God's Secret Agents: Queen Elizabeth's Forbidden Priests and the Hatching of the Gunpowder Plot
By Alice Hogge



HarperCollins; 464 pages; $27.95 and £20

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Gunpowder Plots: A Celebration of 400 Years of Bonfire Night
By Brenda Buchanan, Justin Champion, David Cannadine, David Cressy, Pauline Croft, Antonia Fraser and Mike Jay

Penguin/Allen Lane; 208 pages; £14.99

Buy it at
Amazon.co.uk

from the Board of Ordnance mentions that the gunpowder recovered from Parliament was “decaied”—ie, moist. Perhaps the plot that Britons have celebrated all this time would have been rather a damp squib.

God's Secret Agents: Queen Elizabeth's Forbidden Priests and the Hatching of the Gunpowder Plot.

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British food

The munch of time

Nov 3rd 2005
From The Economist print edition

IN HIS quintessentially English diaries, James Lees-Milne recalls standing by his kitchen window, watching Cecil Beaton take a stroll in the garden. Turning to his housekeeper, he asked if she knew who Beaton was. “He's the cook, isn't he?” she replied. Not exactly, Lees-Milne told her, but a famous photographer. “But he cooks too,” she insisted.

Cecil Beaton couldn't boil an egg, but a little fat book, published by a small independent firm in 1861 became the most famous of all British cookery books. Isabella Mayson, according to her maiden name, was a columnist for the *Englishwoman's Domestic Magazine* and her husband, Sam Beeton, made his fortune publishing the British edition of “Uncle Tom's Cabin”. The book they brought out together, “Beeton's Book of Household Management”, sold 60,000 copies in its first year and 2m by 1868. By that time, Mrs Beeton had died, at the age of 28.

Aimed at the ordinary young married woman who would probably have had to do without domestic servants, save perhaps a chambermaid, Mrs Beeton's book addressed the mistress of the house as though she were the “commander of an army”. It included endless handy hints for folding serviettes and managing children, stressing the importance, in its medical chapters, of both vaccination and leeches.

Kathryn Hughes offers a richly drawn context to the woman who, in addition to her prolific domestic advice, is best known for her recipes: three whole pages for the making of turtle soup and nearly 300 pages for meat of all kinds. The book is widely seen as representing all that is traditionally English, yet there are among the raised game pies and boiled suet puddings, innumerable foreign dishes. Blancmange and fritters mingle with less familiar cuisines. Indeed, in its gathering of the fast mutating Indian dishes—curry, kedgeree and mulligatawny soup—it epitomises fusion cooking over a century before that movement got its name.

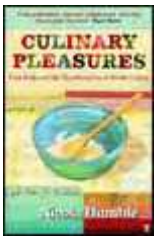
As Nicola Humble shows in her history of cookbooks, Mrs Beeton is the culinary ectoplasm from which all modern food writers descend. The table we can all now produce at home, thanks to clever shopkeepers and busy recipe writers, far from being a wholly contemporary discovery, was in fact the norm in England. And the bland, overboiled, boarding-school food of the mid-20th century, far from representing the real English palate, as many believe, was the product of hardship and not a lack of imagination. In her last chapter, Ms Humble highlights the work of cooks like Nigella Lawson, Annie Bell and Sally Clarke, who argue in favour of pleasurably slow cooking and the self-restraint of eating food that is in season. In failing, however, to mention Rose Prince's “The New English Kitchen” (Fourth Estate), published to great acclaim earlier this

The Short Life & Long Times of Mrs Beeton
By Kathryn Hughes

To be published in America by Knopf in March
Fourth Estate; 525 pages; £20.

Buy it at
Amazon.com
Amazon.co.uk

Culinary Pleasures: Cook Books and the Transformation of British Cuisine
By Nicola Humble



Faber and Faber; 342 pages; £16.99

Buy it at
Amazon.co.uk

year, she has missed a great opportunity. No one bears Mrs Beeton's mantle better.

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Economist.com BOOKS & ARTS

Amazon worldwide bestsellers

Books for cooks

Nov 3rd 2005

When it comes to cookbooks, the British are best

THE Japanese love their sushi slashed, the French their sauces coddled. But the British love their food on the page. Half of the 12 most popular recipe books worldwide are British; indeed, it took a cookbook, the reissue of Simon Hopkinson's Roast Chicken and Other Stories, to overtake Harry Potter earlier this year.

1. Jamie's Italy.
By Jamie Oliver. Michael Joseph. 336 pages; £12

Controversy reigns over whether the tousle-haired telebrity chef is a professional or a poser. None of the recipes here is original and Jamie Oliver does loll about on the cover next to an old Fiat, yet there is something undeniably attractive about this straight-talking, appetising selection of Italian classics.

Click to buy from Amazon.co.uk

2. The Kitchen Diaries: A Year in the Kitchen.
By Nigel Slater. Fourth Estate; 400 pages; £15

Following his hugely successful autobiography, Nigel Slater offers up the recipes he cooks from at home to surprise, seduce or simply to slough off the day.

Click to buy from Amazon.com or Amazon.co.uk

3. Born to Cook II.
By Tim Mälzer. Wilhelm Goldmann; 176 pages; 19.90

A well-photographed, reliable second round from Germany's version of Jamie Oliver.

Click to buy from Amazon.co.uk

4. The South Beach Diet Quick and Easy Cookbook: 200 Delicious Recipes Ready in 30 Minutes or Less.
By Arthur Agatston. Rodale; 320 pages; $17.90

The 30-minute time limit has been South Beachifed, just in time for supper.

Click to buy from Amazon.com or Amazon.co.uk

5. New Cook Book, Limited Edition "Pink Plaid": For Breast Cancer Awareness.
Edited by Tricia Laning. Better Homes and Gardens; 640 pages; $19.77

The 75-year-old cooking bible updated with a new section on beating cancer with lowfat, high-antioxidant miracle foods.

Click to buy from Amazon.com or Amazon.co.uk

6. Roast Chicken and Other Stories.
By Simon Hopkinson. Ebury Press; 224 pages, £7.20

This stroll through 40 of Simon Hopkinson's favourite ingredients is as popular now as it was when it first came out a decade ago.

Click to buy from Amazon.com or Amazon.co.uk

7. The River Cottage Family Cookbook.
By Hugh Fearnley-Whittingstall and Fizz Carr. Hodder & Stoughton; 416 pages; £12

A passionate polemic for shopping, cooking and eating in tune with the seasons, and with toddlers and grandparents in tow.

Click to buy from Amazon.com or Amazon.co.uk

8. The CSIRO Total Wellbeing Diet.
By Manny Noakes. Viking; 220 pages; £6.99

Australia's official bible for losing weight permanently by keeping you satisfied and giving you more energy.

Click to buy from Amazon.co.uk

9. Rachael Ray's 30-Minute Get Real Meals: Eat Healthy Without Going to Extremes.
By Rachael Ray. Clarkson Potter; 256 pages;$12.13

Creative, hassle-free recipes that will appeal to Rachael Ray's legion of Food TV fans.

Click to buy from Amazon.com

10. Low GI Cookbook: Over 80 Delicious Recipes to Help You Lose Weight and Gain Health.
By Louise Blair. Hamlyn; 128 pages; £5.99

Super smoothies and quick-fix lunches for anyone who watches their glycaemic index.

Click to buy from Amazon.com or Amazon.co.uk

11. New British Classics.
By Gary Rhodes. BBC Books; 408 pages; £10.19

Updated versions of steak-and-kidney pie, prawn cocktail, cauliflower cheese and other British greats.

Click to buy from Amazon.com or Amazon.co.uk

12. Complete Cookery Course: Volumes 1-3 in one volume.
By Delia Smith. BBC Books; 664 pages; £9.09

A recipe for virtually every ingredient, from the most reliable cook of them all.

Click to buy from Amazon.com or Amazon.co.uk

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Rong Yiren

Nov 3rd 2005
From The Economist print edition

Corbis

Rong Yiren, a Chinese billionaire, died on October 26th, aged 89

SEVERAL mysteries surrounded the career of Rong Yiren. One was how he could have been vice-chairman of the 5th National Committee of the Chinese People's Political Consultative Conference, vice-chairman of the standing committee of the 6th and 7th National People's Congress, and vice-president of the People's Republic, without ever (to anyone's certain knowledge) joining the Communist Party. Another was how, despite ceding many of his family's business holdings after the 1949 revolution, and losing the rest during the Cultural Revolution of 1966-76, he emerged within a decade as one of the 50 most charismatic businessmen in the world, by *Fortune*'s reckoning, and by 1999, by *Forbes*'s, as China's richest.

The answer to both these mysteries is that he played a very clever and very Chinese game. First, when most of his family, including his brothers, fled from China to Taiwan or the United States after 1949, Mr Rong stayed. He had 24 flour mills to run, besides dyeing, printing and textile factories, employing in all some 80,000 people; his family's business empire, started in 1902, had been among the biggest in the country.

The decision not to flee was brave, and made him nervous: he was “like an ant on a hot pan”, he said later, but stayed calm in front of the workforce. He also presented himself, from the first, as one of those “national” or “patriotic” capitalists who had remained not to enrich himself (far from it!) but to help China end its poverty. His dogged conviction that his country would eventually find capitalism necessary was to be proved right in spades.

Mr Rong's communism, if official at all, was subtle. He supported the Communists, he admitted, with only “one hand” at first. But when he realised this would not do, he raised two, with implicit conditions. If he gave the party what it wanted, he would try to make sure the favour was

returned. After 1956, when he handed over large stakes in his family's businesses to the government, he was given 30m yuan ($12m) compensation, as well as the posts of vice-mayor of Shanghai and, in 1959, vice-minister for the textile industry.

Having gained political ties from canny surrenders, Mr Rong made sure he used them. *Guanxi*, or personal connections, the grease of all commerce and politics in China, helped him survive the Cultural Revolution, more or less. Though his companies were confiscated, his mansions ransacked and he himself reduced to menial work, top members of the party shielded him from further terrors. As a patriotic capitalist, he then confirmed the official account that he had spent the years of Mao Zedong's brutal re-education of “capitalist-roaders” quietly at home, studying and planting flowers.

Capitalism's ambassador

In 1978, all the years of careful positioning bore fruit. Deng Xiaoping decided that China would experiment with capitalism, opening windows to the world, and brought in Mr Rong to find “boldly creative” ways of doing so. He could have picked no one better: urbane, beautifully turned out, educated under the British system at St John's University in Shanghai, a man impeccably loyal to China and to Deng, but also a raging capitalist to his very marrow. (Mr Rong preferred “entrepreneur” to the “red capitalist” tag Deng gave him, but “entrepreneur” hardly caught the force of it.)

Mr Rong, now in his dream job, did not have to look far to find versions of capitalism he liked. In 1979, at the party's behest, he founded CITIC, ostensibly as the investment arm of the Chinese state but also, in effect, his own company. From its very beginnings it was in clover, a state-licensed predator in a land empty of private rivals. Telecoms, utilities and highways were swept up. When Deng in the 1980s set up the Special Economic Zones in southern China, where capitalist forays were permitted, CITIC was first there to exploit the property boom. Mr Rong, roving extensively, found foreign concerns for China to invest in, and foreign investors were in turn lured back to China. Mr Rong's conglomerate now boasts global assets of more than 51 billion yuan ($6.3 billion) and 200 affiliated enterprises, including airlines, Hong Kong banks, timber operations and Australian aluminium smelting.

He himself did nicely, too, as far as anyone could tell. In its 2001 listing *Forbes* backtracked a bit, saying that his wealth ($1.9 billion in 2000) should really be attributed to his son, Larry Yung, head of CITIC-Pacific in Hong Kong. But there was still his mansion in Beijing, his spread in Shanghai and his semi-palace beside a lake in Jiangsu province, near where he was born. Cadillacs were mentioned. Mr Rong even had enough to give $180,000, just before the knife-edge election of 1992, to Britain's Conservative Party.

To what extent public assets leached into private income was something the Chinese government could never quite find out. Certainly it had no system of rules to stop it. Once the dragon of capitalism, even in the safe and suave form of Mr Rong, was let in through the door, government and markets mingled. Some observers outside China wondered why he stayed, but there was no puzzle about it: in China he could not only be rich as Croesus, but vice-president too.

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Overview

Nov 3rd 2005
From The Economist print edition

America's GDP grew at an annual rate of 3.8% in the third quarter, despite extreme weather and expensive petrol. The Federal Reserve raised its benchmark lending rate by 0.25% to 4.0%, its 12th hike in a row. It warned that higher costs, especially for energy, might yet pass through into consumer prices, but said it is satisfied that long-term inflation expectations remain "contained".

The Fed's 12-step programme is making its mark on **bond markets**. The price of ten-year American Treasury bonds fell, pushing yields up above 4.6%. Bonds elsewhere are also losing their appeal. Citigroup's World Government Bond Index, which measures total returns on the 21 biggest government bond markets, dipped to its lowest level for over a year. While bonds suffer, the **dollar** thrives: during trading on November 2nd, it bought ¥116.87, its strongest rate against the yen since 2003.

The confidence of **American consumers**, which plunged in September, slipped a little further last month, according to the University of Michigan. Consumers' disposable income rose by 1.9% in September, after falling by 1.1% in August, according to the Department of Commerce. But they are still not saving any of it: outlays exceeded incomes by $32.0 billion in September, leaving the personal saving rate at –0.4%.

Japan's Nikkei stockmarket index reached its highest level since May 2001; the Topix, its highest since October 2000. Industrial production grew by a modest 1.0% in the year to September. But the purchasing managers index of manufacturing activity reached its highest reading for over a year. Japan's mild deflation continues: core consumer prices, excluding food, fell by 0.1% in the year to September.

The European Central Bank, by contrast, must contend with **euro-area** inflation that remains well above its ceiling target rate of 2.0%. Consumer prices rose by an estimated 2.5% in the year to October. German unemployment fell by 36,000 to 4.8m (adjusted for the season) or 11.6% of the workforce. The unemployment rolls have now fallen, albeit slowly, for six months in seven.

In **Britain**, house prices rose in October by 1.3%, according to the Nationwide, a big mortgage lender, leaving prices 3.3% higher than a year earlier. This time last year, house-price inflation, by the same measure, was over 15%.

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Output, demand and jobs

Nov 3rd 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q2	+ 5.2	+ 2.6	+ 3.3	+ 0.7	Q2	+ 1.2	Q3	5.1	Sep	5.5
Austria	+ 2.1	Q2	+ 1.8	+ 1.8	+ 2.0	+ 4.4	Aug	– 1.5	Jul	5.2	Sep	4.9
Belgium	+ 1.1	Q3	+ 1.6	+ 1.3	+ 1.7	– 2.3	Aug	+ 7.4	Aug	13.5	Sep†	13.2
Britain	+ 1.6	Q3	+ 1.6	+ 1.9	+ 2.1	– 1.9	Aug	+ 0.7	Sep	4.7	Aug††	4.7
Canada	+ 2.7	Q2	+ 3.2	+ 2.9	+ 3.0	+ 1.7	Aug	+ 6.7	Jul	6.7	Sep	7.0
Denmark	+ 4.3	Q2	+ 6.6	+ 2.0	+ 2.1	+ 0.1	Aug	+ 8.4	Sep	5.5	Sep	6.3
France	+ 1.3	Q2	+ 0.5	+ 1.4	+ 1.6	+ 2.0	Aug	+ 4.1	Aug	9.8	Sep	10.0
Germany	+ 0.6	Q2	nil	+ 0.9	+ 1.1	+ 2.1	Aug	– 0.7	Sep	11.6	Oct§	10.7
Italy	+ 0.1	Q2	+ 2.7	nil	+ 0.9	+ 6.1	Aug	– 1.6	Jul	7.7	Jun	8.1
Japan	+ 1.4	Q2	+ 3.3	+ 2.2	+ 2.0	+ 1.0	Sep	+ 1.9	Aug	4.2	Sep	4.6
Netherlands	+ 1.3	Q2	+ 4.9	+ 0.6	+ 1.6	– 0.3	Aug	+ 0.7	Jul	6.6	Sep**	6.1
Spain	+ 3.4	Q2	+ 3.4	+ 3.3	+ 2.9	+ 3.8	Aug	+ 3.1	Aug	9.4	Aug	10.8
Sweden	+ 2.3	Q2	+ 2.6	+ 2.3	+ 2.7	– 4.0	Aug	+ 6.5	Sep	5.4	Sep†	5.8
Switzerland	+ 1.0	Q2	+ 1.1	+ 1.1	+ 1.6	+ 3.9	Q2	+ 4.7	Aug	3.6	Sep†	3.7
United States	+ 3.6	Q3	+ 3.8	+ 3.5	+ 3.2	+ 2.0	Sep	+ 5.0	Aug	5.1	Sep	5.4
Euro area	+ 1.1	Q2	+ 1.2	+ 1.2	+ 1.5	+ 2.6	Aug	+ 2.0	Aug	8.6	Aug	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.2	Q2	– 6.3	na	na	– 0.8	Sep	+ 5.8	Aug	8.3	Sep†	8.4
Greece	+ 3.7	Q2	na	na	na	+ 1.4	Aug	+ 4.0	Jul	9.9	Mar	10.8
Iceland	+ 6.8	Q2	na	na	na	na		na		1.8	Aug†	2.9
Ireland	+ 4.1	Q2	+ 6.5	na	na	+16.6	Aug	+ 4.2	Aug	4.4	Sep	4.4
Luxembourg	+ 3.1	Q1	na	na	na	+15.7	Jul	– 4.4	Aug	4.7	Sep	4.2
New Zealand	+ 2.6	Q2	+ 4.5	na	na	+ 3.5	Q4	+ 5.9	Q2	3.7	Q2	4.0
Norway	+ 4.8	Q2	+ 5.2	na	na	+ 9.5	Aug	+ 4.2	Sep	4.8	Sep‡	4.5
Portugal	+ 0.5	Q2	+ 4.1	na	na	+ 0.1	Sep	+ 2.5	Sep	7.2	Q2†	6.3

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Jun-Aug; claimant count rate 2.8% in Sep.
§EU harmonised rate 9.3% in Aug. **Jul-Sep.

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Prices and wages

Nov 3rd 2005
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2005	2006	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 3.0	Q3	+ 2.3	+ 2.6	+ 2.7	+ 6.2	Q3	+ 6.1	+ 5.8	Q2	+ 3.0
Austria	+ 2.4	Sep	+ 2.1	+ 2.2	+ 2.0	+ 1.5	Sep	+ 6.0	+ 2.3	Sep	+ 2.0
Belgium	+ 2.5	Oct	+ 2.9	+ 2.5	+ 2.2	+ 1.5	Sep	+ 6.0	+ 2.5	Jul	+ 2.2
Britain	+ 2.5	Sep*	+ 1.1	+ 2.1	+ 2.2	+ 3.3	Sep	+ 3.1	+ 4.2	Aug†	+ 3.8
Canada	+ 3.4	Sep	+ 1.8	+ 2.3	+ 2.4	+ 0.6	Sep	+ 4.8	+ 1.1	Aug	+ 2.0
Denmark	+ 2.4	Sep	+ 1.1	+ 1.6	+ 1.9	+ 5.3	Sep	+ 3.4	+ 2.9	Q2	+ 3.1
France	+ 2.2	Sep	+ 2.1	+ 2.0	+ 1.7	+ 3.4	Sep	+ 3.0	+ 2.9	Q2	+ 2.8
Germany	+ 2.4	Oct	+ 2.0	+ 1.9	+ 1.8	+ 3.6	Sep	+ 3.4	+ 0.9	Aug	+ 1.6
Italy	+ 2.2	Oct	+ 2.0	+ 2.2	+ 2.1	+ 3.8	Sep	+ 3.8	+ 3.1	Sep	+ 2.5
Japan	– 0.3	Sep	nil	– 0.1	+ 0.3	+ 1.7	Sep	+ 1.9	– 2.7	Aug	+ 2.8
Netherlands	+ 1.6	Oct	+ 1.4	+ 1.5	na	+ 4.9	Aug	+ 5.5	+ 1.0	Sep	+ 0.9
Spain	+ 3.7	Sep	+ 3.2	+ 3.2	+ 3.1	+ 5.4	Sep	+ 4.6	+ 3.4	Q2	+ 3.1
Sweden	+ 0.6	Sep	+ 0.6	+ 0.7	+ 1.5	+ 4.2	Sep	+ 2.1	+ 3.0	Aug	+ 2.6
Switzerland	+ 1.3	Oct	+ 1.3	+ 1.2	+ 1.2	+ 1.5	Sep	+ 1.5	+ 0.9	2004	+ 1.4
United States	+ 4.7	Sep	+ 2.5	+ 3.2	+ 3.0	+ 6.7	Sep	+ 3.3	+ 2.6	Sep	+ 2.4
Euro area	+ 2.5	Oct	+ 2.4	+ 2.2	+ 1.9	+ 4.0	Aug	+ 3.1	+ 2.3	Q2	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.2	Sep	+ 0.4	na	na	+ 3.8	Sep	+ 2.5	+ 4.0	Q2	+ 3.8
Greece	+ 3.9	Sep	+ 2.7	na	na	+ 6.7	Sep	+ 4.9	na		na
Iceland	+ 4.6	Oct	+ 3.7	na	na	+ 4.2	Oct	+ 5.6	+ 6.9	Sep	+ 5.3
Ireland	+ 3.0	Sep	+ 2.5	na	na	– 0.2	Sep	– 0.8	+ 3.4	Q2	+ 4.3
Luxembourg	+ 2.9	Sep	+ 2.0	na	na	+ 4.1	Aug	+11.3	+ 0.7	Jul	+ 2.2
New Zealand	+ 3.4	Q3	+ 2.5	na	na	+ 4.7	Q2	+ 1.5	+ 2.6	Q2	+ 2.3
Norway	+ 2.0	Sep	+ 1.1	na	na	+17.9	Sep	+20.3	+ 3.8	Q2	+ 4.1
Portugal	+ 2.8	Sep	+ 2.1	na	na	+ 4.5	Sep	+ 4.5	nil	Aug	– 2.2

*RPI inflation rate 2.7% in Sep. †Jun-Aug.

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Access to capital

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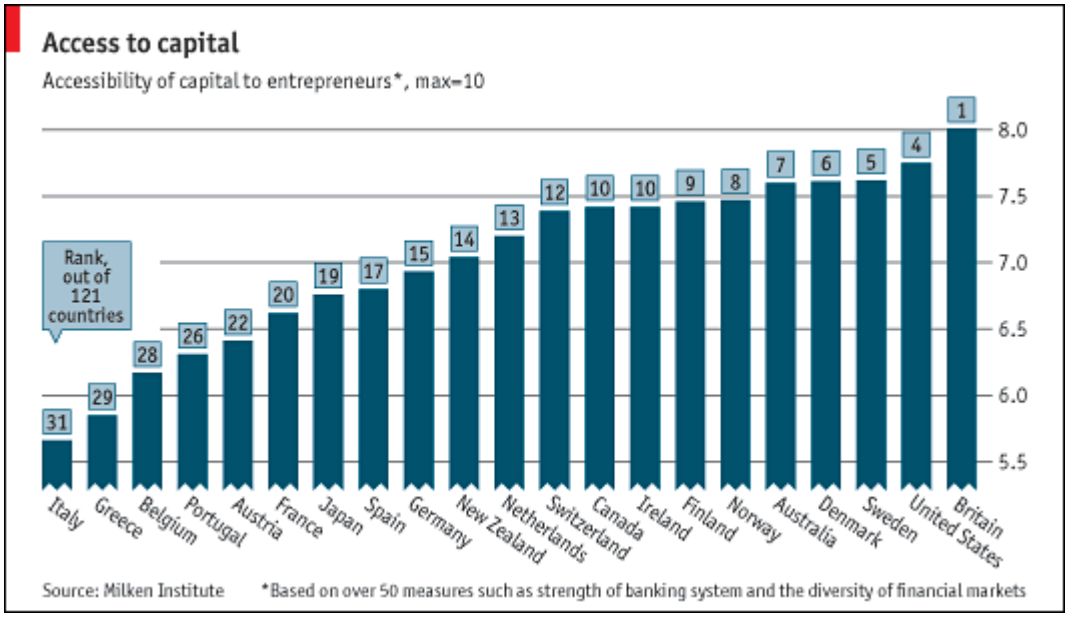
Britain has the best financial environment for entrepreneurs, according to the latest Capital Access Index produced by the Milken Institute, a think-tank in California. Since 1998 the institute has ranked countries according to the breadth, depth and vitality of their capital markets. This year's index covers 121 countries, which between them represent 92% of global GDP. Hong Kong and Singapore beat America into fourth place.



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Money and interest rates

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	Money supply* % change on year ago			Interest rates % a year (Nov 2nd 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 7.6	+ 9.8	Sep	5.65	5.44	5.29	5.45	5.37	6.40
Britain	+ 5.4	+11.2	Sep	4.55	4.84	4.39	4.35	4.79	5.16
Canada	+10.9	+ 9.8	Sep	3.06	2.61	3.66	4.18	4.45	5.34
Denmark	+22.8	+16.3	Sep	2.30	2.25	2.70	3.40	3.94	4.96
Japan	+ 5.2	+ 2.1	Sep	0.02	0.03	0.29	1.57	1.54	1.64
Sweden	+ 2.8	+ 5.6	Sep	1.49	1.99	2.29	3.29	4.18	3.11
Switzerland	+ 3.2	+ 6.3	Sep	0.88	0.74	1.58	2.10	2.52	2.34
United States	+ 0.3	+ 6.6	Sep	4.23	2.14	4.43	4.60	4.07	5.55
Euro area†	+11.2	+ 8.5	Sep	2.26	2.16	2.62	3.42	3.86	3.78

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.80%, Japan No. 273 1.57%. Central bank rates: US fed funds 4.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 3rd 2005
From The Economist print edition

2000=100

	Oct 25th	Nov 1st*	% change on one month	% change on one year
Dollar index				
All items	135.1	134.1	+ 0.2	+11.6
Food	124.4	122.5	– 1.0	+ 9.2
Industrials				
All	149.0	149.1	+ 1.5	+14.2
Nfa†	135.2	133.2	– 1.8	+ 9.9
Metals	156.6	157.7	+ 3.1	+16.3
Sterling index				
All items	114.8	115.4	+ 0.2	+16.4
Euro index				
All items	103.3	103.4	– 0.2	+18.2
Yen index				
All items	143.8	145.2	+ 2.4	+22.5
Gold				
$ per oz	472.30	459.75	– 1.3	+ 9.1
West Texas Intermediate				
$ per barrel	62.32	59.88	– 6.2	+20.8

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 3rd 2005
From The Economist print edition

Market indices

	Nov 2nd	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,408.8	4,617.4	3,905.5	+ 0.2	- 4.5	+ 8.8	+ 2.9
Austria (ATX)	3,315.0§	3,503.9	2,415.0	+ 3.8	- 5.4	+36.3	+21.0
Belgium (Bel 20)	3,277.2	3,373.8	2,958.8	+ 0.4	-11.0	+11.8	- 0.8
Britain (FTSE 100)	5,358.6	5,501.6	4,783.6	+ 2.5	-22.7	+11.3	+ 2.9
Canada (Toronto Composite)	10,585.7	11,081.2	9,006.2	+ 2.9	- 7.1	+14.5	+16.2
Denmark (OMXCB)	334.0	341.9	257.8	+ 2.0	- 2.3	+29.5	+14.6
France (SBF 250)	3,089.0	3,248.3	2,633.6	+ 0.3	-29.6	+17.3	+ 4.1
(CAC 40)	4,429.7	4,650.2	3,816.1	+ 0.4	-36.0	+15.9	+ 2.9
Germany (DAX)*	4,954.8	5,138.0	4,178.1	+ 1.1	-38.6	+16.4	+ 3.3
Italy (S&P/MIB)	32,937.0	34,874.0	30,645.0	+ 0.3	-34.3	+ 6.6	- 5.4
Japan (Nikkei 225)	13,894.8	13,894.8	10,825.4	+ 3.7	-64.3	+20.9	+ 6.1
(Topix)	1,474.3	1,474.3	1,109.2	+ 4.7	-48.9	+28.2	+12.5
Netherlands (AEX)	397.1	408.7	347.0	+ 1.6	-43.4	+14.1	+ 1.3
Spain (Madrid SE)	1,124.1	1,176.9	950.9	- 0.4	- 4.5	+17.2	+ 4.0
Sweden (Affarsvarlden Gen)	268.1	273.7	218.9	+ 1.6	-33.0	+21.2	+ 0.9
Switzerland (Swiss Market)	7,117.4	7,117.4	5,669.6	+ 2.1	-15.4	+25.0	+11.2
United States (DJIA)	10,472.7	10,940.6	10,012.4	+ 1.2	-10.7	- 2.9	- 2.9
(S&P 500)	1,214.8	1,245.0	1,137.5	+ 2.0	-20.5	+ 0.2	+ 0.2
(NASDAQ Comp)	2,144.3	2,218.2	1,904.2	+ 2.1	-57.5	- 1.4	- 1.4
Europe (FTSEurofirst 300)†	1,205.1	1,242.0	1,038.6	+ 1.6	-29.3	+15.7	+ 2.7
Euro area (FTSE Euro 100)†	1,013.1	1,056.1	894.4	+ 0.6	-34.7	+12.5	- 0.2
World (MSCI)‡	1,205.8	1,225.6	1,115.0	+ 1.9	-16.8	+ 3.1	+ 3.1
World bond market (Citigroup)††	620.8	662.3	619.7	- 0.5	- 6.3	- 6.8	- 6.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms. §Oct 25th.

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Trade, exchange rates and budgets

Nov 3rd 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2005	Current-account balance The Economist poll % of GDP, forecast 2006	Exchange rate trade-weighted† 2000=100 Nov 2nd	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Nov 2nd	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2005‡
Australia	− 16.1 Sep	− 43.1 Q2	− 4.8	− 4.4	116.8	113.4	1.35	1.32	2.39	1.63	1.15	+ 0.9
Austria	− 1.2 Aug	− 0.3 Aug	− 0.4	− 0.6	104.1§	103.9	0.83	0.78	1.47	–	0.71	− 2.0
Belgium	+ 16.3 Aug	+ 9.2 Jun	+ 2.8	+ 2.7	104.7§	104.4	0.83	0.78	1.47	–	0.71	− 0.5
Britain	−115.6 Aug	− 23.5 Q2	− 2.4	− 2.5	99.4	99.3	0.56	0.54	–	0.68	0.48	− 2.9
Canada	+ 45.6 Aug	+ 16.3 Q2	+ 1.6	+ 1.5	122.9	118.3	1.18	1.21	2.10	1.42	1.01	+ 1.2
Denmark	+ 9.9 Aug	+ 9.7 Aug	+ 2.9	+ 2.7	106.1	106.5	6.19	5.81	11.0	7.46	5.30	+ 1.8
France	− 27.1 Aug	− 25.9 Aug	− 0.8	− 0.8	107.3§	106.9	0.83	0.78	1.47	–	0.71	− 3.0
Germany	+200.2 Aug	+110.4 Aug	+ 3.7	+ 3.5	105.1§	104.7	0.83	0.78	1.47	–	0.71	− 3.5
Italy	− 8.8 Aug	− 28.5 Aug	− 1.4	− 1.5	76.8§	76.6	0.83	0.78	1.47	–	0.71	− 4.4
Japan	+104.9 Aug	+163.7 Aug	+ 3.4	+ 3.3	82.1	88.3	117	106	207	141	–	− 6.1
Netherlands	+ 40.3 Aug	+ 28.3 Q2	+ 3.7	+ 3.6	104.2§	103.8	0.83	0.78	1.47	–	0.71	− 2.2
Spain	− 92.9 Aug	− 75.9 Jul	− 6.1	− 6.0	77.4§	77.2	0.83	0.78	1.47	–	0.71	+ 0.5
Sweden	+ 21.3 Sep	+ 27.9 Q2	+ 7.1	+ 6.6	93.0	99.9	7.98	7.08	14.2	9.63	6.83	+ 0.8
Switzerland	+ 7.2 Sep	+ 51.4 Q2	+11.4	+10.9	107.3	108.5	1.28	1.20	2.27	1.54	1.09	− 1.0
United States	−737.4 Aug	−749.7 Q2	− 6.5	− 6.6	86.8	82.8	–	–	1.77	1.21	0.86	− 4.1
Euro area	+ 49.4 Aug	+ 6.0 Aug	+ 0.2	+ 0.2	116.2	117.7	0.83	0.78	1.47	–	0.71	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 11.4 Aug	+ 7.7 Aug	na	na	81.7§	81.5	0.83	0.78	1.47	–	0.71	+ 1.3
Greece	− 33.8 Aug	− 16.2 Aug	na	na	60.0§	59.9	0.83	0.78	1.47	–	0.71	− 3.8
Iceland	− 1.1 Aug	− 1.6 Q2	na	na	105.1**	95.9	59.5	68.4	106	71.8	50.9	+ 1.1
Ireland	+ 40.3 Aug	− 3.9 Q2	na	na	94.6§	93.9	0.83	0.78	1.47	–	0.71	− 0.7
Luxembourg	− 4.4 Jul	+ 3.5 Q2	na	na	104.7§	104.4	0.83	0.78	1.47	–	0.71	− 0.8
New Zealand	− 4.1 Sep	− 8.2 Q2	na	na	138.8	131.5	1.46	1.45	2.59	1.76	1.25	+ 3.2
Norway	+ 44.6 Sep	+ 40.8 Q2	na	na	112.7	107.0	6.46	6.39	11.5	7.80	5.53	+ 14.4
Portugal	− 14.0 Jul	− 16.5 Aug	na	na	93.4**	93.4	0.83	0.78	1.47	–	0.71	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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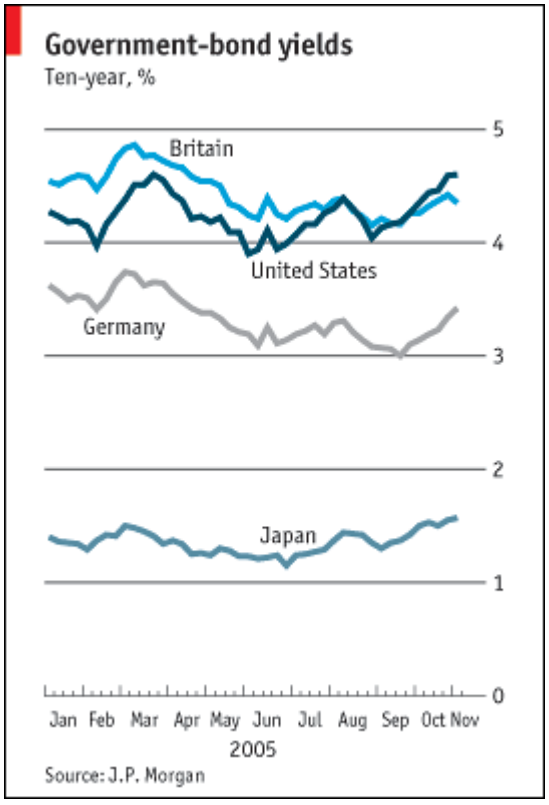
Government-bond yields

Nov 3rd 2005
From The Economist print edition



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Overview

Nov 3rd 2005
From The Economist print edition

Indonesia's inflation rate rose to 17.9% in October (from 9.1% in September)—its highest for six years. This followed an increase in fuel prices as the government sought to trim its subsidy bill. The central bank raised its interest rate by 125 basis points to 12.25%.

South Korea's GDP growth quickened to 4.4% in the year to the third quarter, up from 3.3% in the previous quarter. Domestic demand and exports both strengthened.

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Economy

Nov 3rd 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.4	Q3	+16.5	Sep	+ 0.9	Sep	+96.4	Sep	+68.7	2004	769.0	Sep
Hong Kong	+ 6.8	Q2	– 0.1	Q2	+ 1.6	Sep	– 9.5	Sep	+21.3	Q2	122.3	Sep
India	+ 8.1	Q2	+ 7.4	Aug	+ 3.4	Aug	–35.5	Sep	–16.0	Q2	132.2	Sep
Indonesia	+ 5.5	Q2	+ 7.4	Aug	+17.9	Oct	+26.7	Sep	+ 4.0	Q2	29.9	Aug
Malaysia	+ 4.1	Q2	+ 4.1	Aug	+ 3.4	Sep	+24.1	Aug	+18.0	Q2	79.7	Sep
Philippines	+ 4.8	Q2	+ 7.3	Aug	+ 7.0	Sep	– 1.3	Aug	+ 3.2	Jun	16.0	Sep
Singapore	+ 6.0	Q3	+21.1	Sep	+ 0.6	Sep	+16.8	Sep	+32.5	Q2	115.6	Sep
South Korea	+ 4.4	Q3	+ 7.2	Sep	+ 2.5	Oct	+25.8	Oct	+18.6	Sep	206.7	Sep
Taiwan	+ 3.0	Q2	+ 6.2	Sep	+ 3.1	Sep	+ 1.7	Sep	+13.3	Q2	253.8	Sep
Thailand	+ 4.4	Q2	+ 4.8	Sep	+ 6.2	Oct	– 6.9	Sep	– 2.0	Sep	48.5	Sep
Argentina	+10.1	Q2	+ 6.8	Sep	+10.3	Sep	+11.4	Sep	+ 2.9	Q2	24.8	Sep
Brazil	+ 3.9	Q2	+ 3.8	Aug	+ 6.0	Sep	+41.9	Oct	+13.1	Sep	56.5	Sep
Chile	+ 6.5	Q2	+ 5.8	Sep	+ 3.9	Sep	+ 8.9	Sep	+ 0.6	Q2	15.7	Sep
Colombia	+ 5.3	Q2	+ 5.7	Aug	+ 5.3	Oct	+ 1.7	Jul	– 0.8	Q2	14.8	Sep
Mexico	+ 3.1	Q2	+ 2.1	Aug	+ 3.5	Sep	– 9.4	Sep	– 8.4	Q2	68.2	Aug
Peru	+ 6.7	Aug	+ 9.4	Aug	+ 1.3	Oct	+ 4.1	Aug	+ 0.4	Q2	12.8	Sep
Venezuela	+11.1	Q2	+ 8.0	Jul	+16.0	Oct	+24.7	Q2	+17.7	Q2	24.7	Jul
Egypt	+ 5.2	Q1	+ 3.3	2004†	+ 4.7	Aug	–10.4	Q2	+ 2.9	Q2	19.0	Aug
Israel	+ 4.8	Q2	+ 3.9	Aug	+ 1.9	Sep	– 8.3	Sep	+ 1.3	Q2	28.5	Sep
South Africa	+ 4.5	Q2	+ 3.5	Aug	+ 4.4	Sep	– 3.0	Sep	– 8.6	Q2	17.6	Sep
Czech Republic	+ 5.1	Q2	+ 8.6	Aug	+ 2.2	Sep	+ 1.4	Aug	– 4.1	Q2	29.9	Sep
Hungary	+ 4.1	Q2	+ 6.9	Aug	+ 3.7	Sep	– 3.5	Aug	– 8.6	Q2	17.5	Sep
Poland	+ 2.8	Q2	+ 5.5	Sep	+ 1.8	Sep	– 3.6	Aug	– 0.5	Aug	39.9	Aug
Russia	+ 6.1	Q2	+ 5.2	Sep	+12.4	Sep	+113.4	Aug	+78.3	Q2	159.6	Sep
Turkey	+ 4.2	Q2	+ 8.3	Aug	+ 7.5	Oct	–41.2	Sep	–20.7	Aug	41.2	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 9.9	Q2	+12.8	Sep	+ 4.9	Sep	– 2.4	Aug	– 1.4	Aug	1.8	Aug
Latvia	+11.6	Q2	+ 8.9	Aug	+ 7.2	Sep	– 2.8	Aug	– 1.7	Aug	2.2	Aug
Lithuania	+ 7.6	Q3	na		+ 2.6	Sep	– 3.2	Aug	– 1.5	Aug	3.5	Aug
Slovakia	+ 5.1	Q2	+ 4.3	Aug	+ 2.2	Sep	– 1.9	Aug	– 2.4	Jul	15.4	Aug
Slovenia	+ 5.2	Q2	+ 1.4	Aug	+ 3.1	Oct	– 1.3	Aug	+ 0.2	Aug	8.1	Jun
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 8.5	Sep	– 7.9	Sep	– 1.5	Q2	10.2	Sep
Saudi Arabia	+ 6.2	2005‡	na		+ 0.3	Jul	+85.2	2004	+51.5	2004	24.8	Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Nov 3rd 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 2nd		Dec 31st 2004	
	Nov 2nd	year ago	Nov 2nd	% a year		one week	in local currency	in $ terms
China	8.09	8.28	14.3	2.20	1,161.5	+0.7	– 12.7	– 10.6
Hong Kong	7.75	7.78	13.8	4.32	14,597.5	+1.0	+ 2.6	+ 2.8
India	45.2	45.3	80.2	5.56	8,072.8	+1.2	+ 22.3	+ 17.6
Indonesia	10,058	9,120	17,848	14.86	1,065.0	+0.3	+ 6.5	– 1.7
Malaysia	3.78	3.80	6.70	2.95	913.9	+1.0	+ 0.7	+ 1.3
Philippines	54.7	56.4	97.1	8.25	2,007.1	+3.8	+ 10.1	+ 12.9
Singapore	1.69	1.67	3.01	2.50	2,255.5	+1.2	+ 9.2	+ 5.2
South Korea	1,040	1,117	1,845	3.95	1,208.4	+2.5	+ 34.9	+ 34.3
Taiwan	33.6	33.4	59.6	1.55	5,870.4	+3.0	– 4.4	– 9.8
Thailand	40.9	41.2	72.5	4.25	699.9	+2.2	+ 4.8	– 0.4
Argentina	2.99	2.95	5.31	6.88	1,639.0	+1.8	+ 19.2	+ 18.3
Brazil	2.24	2.83	3.98	18.95	30,899.0	+3.9	+ 18.0	+ 39.8
Chile	547	605	971	4.32	9,834.0	–0.6	+ 9.7	+ 11.5
Colombia	2,292	2,560	4,067	6.46	7,452.3	+5.4	+ 71.5	+ 76.0
Mexico	10.8	11.4	19.1	8.80	15,896.5	+1.5	+ 23.1	+ 27.4
Peru	3.37	3.32	5.98	3.02	4,887.1	–2.3	+ 31.7	+ 28.1
Venezuela	2,794§	2,410§	4,957	11.69	19,921.5	+2.5	– 33.5	– 38.6
Egypt	5.76	6.24	10.22	9.23	49,839.3	+4.4	+102.7	+113.6
Israel	4.65	4.44	8.26	4.07	766.3	+0.9	+ 19.0	+ 10.5
South Africa	6.65	6.07	11.8	7.25	16,566.9	+0.8	+ 30.9	+ 10.9
Czech Republic	24.5	24.6	43.4	2.22	1,393.5	+3.4	+ 35.0	+ 23.2
Hungary	207	192	367	6.26	21,175.0	+1.8	+ 43.6	+ 25.4
Poland	3.28	3.36	5.83	4.64	32,801.7	+2.5	+ 23.1	+ 12.4
Russia	28.5	28.8	50.7	13.00	964.4‡	+5.9	+ 61.7	+ 57.0
Turkey	1.35	1.46	2.39	15.51	33,152.1	+5.3	+ 32.8	+ 32.9
EM (MSCI)*	1.00	1.00	1.77	na	634.6	+3.1	+ 17.1	+ 17.1
EMBI+†	1.00	1.00	1.77	na	355.4	+0.6	+ 7.8	+ 7.8

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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